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Property Rights and the Environment
Should farmers have a right to compensation?

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Table of Contents

Acknowledgements	iv
Summary	v
1. Introduction	1
2. What are property rights?	3
3. What do the farm lobby groups want?	7
4. Farmers' interests in land and water resources	12
5. The existing compensation framework	15
5.1 The Commonwealth and territory governments	15
5.2 The states	18
6. Justifying restrictions on property rights	20
6.1 Open access, communal ownership and externalities	20
6.2 Incomplete information	22
6.3 Dealing with market failure: beneficiary pays or polluter pays?	22
7. Compensation and social welfare	25
7.1 Uncertainty	25
7.2 Diversion of public resources	29
7.3 Inter-temporal transaction costs	29
7.4 Legal rights to compensation vs. discretionary compensation	33
7.5 Additional subsidies	34
7.6 Double payment	36
7.7 Reduced incentives to improve practices and the domino effect	37
7.8 Excessive conservation	37
7.9 Summary of impacts on net social welfare	41
8. Compensation and equity	43
8.1 The argument in favour of compensation	43
8.2 How are other interests in property treated?	43
8.3 Agricultural subsidies and other rural benefits	50
8.4 Ownership and control of land and water resources	52
9. Conclusions	54
References	57

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Summary

Over the past decade, governments across Australia have introduced a range of laws to provide greater protection for native vegetation and biodiversity. More recently, the recognition that Australia's rivers and wetlands have been significantly degraded has led to efforts to reclaim water allocations from farmers in order to increase environmental flows and relieve pressure on groundwater supplies. In response, farm lobby groups have campaigned to improve the security of farmers' property rights in land and water resources.

At the heart of this campaign is the demand that farmers be provided with additional statutory rights to compensation when restrictions are placed on their ability to use or clear land and when water allocations are reduced for environmental purposes. At its most extreme, this request roughly equates to a claim for absolute ownership of all land and water resources that are used for agricultural purposes. However, in most cases, farm lobby groups have expressed a willingness to confine the right to compensation to those instances when farmers' interests are abrogated for 'public good' environmental purposes.

This request has been justified on the grounds of equity and the economic argument that the provision of more secure property rights will stimulate greater investment and improve the allocation of scarce agricultural resources. Notwithstanding the lack of evidence to support these arguments, many have reacted favourably to the campaign of the farm lobby groups.

This paper explains the nature of property rights, evaluates the property rights debate as it relates to agriculture in Australia, and analyses whether farmers should be provided with additional rights to compensation when their property rights in land and water are restricted or extinguished for environmental purposes.

Farmers' interests in land and water resources

Despite the rhetoric that is often associated with the property rights debate, farmers do not own any land in an absolute sense. Irrespective of whether they hold a freehold title, leasehold title, or a mere licence, the government remains the ultimate owner of the land. Their interests are, and always have been, subject to the government's underlying interests in the land and its rights to regulate how the land is used (although there are legal limits on governments' abilities to acquire land and regulate land use and governments are already required to compensate landholders in certain circumstances).

The situation with respect to farmers' interests in water is similar to those concerning their interests in land. While there are differences between jurisdictions, it is generally the case that state and territory governments 'own', or at the very least have the right to control, the freshwater resources within their borders. Farmers' rights to access and use water are primarily derived from licences granted by the state and territory governments. Hence, it is the governments that actually own Australia's water resources, not the farmers.

Justifying restrictions on property rights

Market failure is the cause of many environmental problems. To resolve these problems, policy makers have two broad choices: polluter pays policies and beneficiary pays policies. The farmers' call for compensation for restrictions on property rights is a form of the beneficiary pays principle. That is, if the state wants to restrict the property rights of farmers to protect the public good, it must pay them for at least some of the benefits derived by the community.

It is generally held that polluter pays policies are more economically efficient than beneficiary pays policies as they force producers to internalise all costs of production and allow market forces to determine the subsequent allocation of resources. Beneficiary pays policies have several inherent weaknesses. Most particularly, by paying producers to stop undertaking an activity that degrades the environment, there is a transfer of resources from the broader community to the producer, which decreases social welfare as those resources are no longer available for other purposes. It also lowers the per unit cost of production, which artificially lowers the price of the producer's product and encourages consumers to purchase even more of the environmentally harmful products.

Despite the well-known flaws in beneficiary pays policies, they are often preferred by governments as they typically have lower political costs than polluter pays approaches. This is particularly true of Australia in relation to environmental problems that are caused by agricultural activities and is due to Australia's electoral system which ensures that farmers and rural communities are able to exert a disproportionate influence on electoral outcomes. This may explain the Howard Government's enthusiasm to embrace the farm lobby groups' calls for farmers to be provided with additional statutory rights to compensation.

Interests in land

The paper concludes that there is no case for providing farmers with additional statutory rights to compensation when their ability to use land for productive purposes is restricted in order to achieve environmental outcomes. The nature of farmers' interests in land, the treatment of other forms of property (particularly native title and interests in urban land), and the extent of government subsidies to agriculture all suggest it would be inequitable to provide these rights to farmers without creating similar rights for other forms of property. In addition, if these rights are created it is unlikely to result in a significant increase in agricultural investment or output.

Interests in water

As in the case of farmers' interests in land, equity principles do not support the creation of additional statutory rights to compensation for reductions in farmers' water allocations that are designed to achieve environmental outcomes; this is true irrespective of whether the benefits are described as private or public good outcomes. However, there is an argument that the provision of additional statutory rights to compensation for restrictions in water allocations could increase agricultural output.

Irrigated agriculture is responsible for a large proportion of agricultural output and profits. By providing additional legal rights to compensation for changes in water

entitlements, governments could lessen uncertainty for irrigators and financiers and thereby encourage greater water trading and additional investment in irrigated agriculture. However, the existing evidence regarding the economic benefits of providing more certain property rights in water is unconvincing with a number of studies suggesting the economic gains could be limited.

Possibly of greater importance, however, is the fact that by providing greater protection for farmers' property rights in water, governments will limit their ability to respond to environmental and other public benefit issues in the future. It will also divert resources from other government programs, lead to additional subsidies being provided to the agricultural sector and diminish incentives to improve natural resource management practices. As changes in the ecological condition of Australia's water resources and social preferences are inevitable (particularly due to the risks associated with climate change), there is a significant risk that the costs of providing additional rights to compensation could outweigh the benefits to extractive users.

The compensation framework proposed under the National Water Initiative has failed to deal adequately with the risks associated with the creation of additional statutory rights to compensation. There is some scope for uncompensated reductions to be made in farmers' water entitlements. Most importantly, there is no obligation to provide compensation for reductions in water allocations that arise as a result of attempts to address *known* over-allocation or overuse in water systems. This provision presents the relevant states and territories with an opportunity to address stressed and over-allocated surface and groundwater systems before the rights to compensation come into operation. However, there is a significant risk that farmers will use their political influence to resist attempts to address known over-allocation and overuse problems. Such a strategy will ensure higher profitability for farmers in the short term (due to continued access to plentiful water) and in the long term (by increasing the size of any compensation payments). However, it will do so at the expense of the environment and the public good.

Even if steps are taken to address known over-allocation and overuse problems, the National Water Initiative provides relevant governments with very little scope to make uncompensated cutbacks in allocations in the future. This will prevent the maximisation of social welfare from water resources as it will impede the ability of governments to respond to changes in the ecological condition of water resources and social preferences.

Conclusion

The calls from farm lobby groups for a legal right to compensation for restrictions on farmers' property rights in land are excessive and need to be balanced against the interests of the broader community. The existing rights to compensation are adequate. Expanding the rights to compensation to protect farmers' interests in land will result in a large transfer of resources from taxpayers to farmers without any notable improvement in agricultural productivity, environmental outcomes or social welfare. Indeed, there is a significant risk it will result in substantially worse environmental outcomes. Similarly, the risk allocation framework proposed in the National Water Initiative that relates to farmers' property rights in water is inequitable and creates impediments to the efficient allocation of water resources.

1. Introduction

During the 1990s and early 2000s, a range of environmental laws were introduced in several jurisdictions in Australia that restricted the ability of farmers to clear native vegetation and sought to protect threatened species and ecological communities. These legislative measures were prompted by growing concern about the rate of vegetation loss and declining biodiversity. At the same time, there has been growing disquiet about the ecological health of Australia's freshwater resources, particularly in the Murray-Darling Basin. This has led to calls for irrigators' water entitlements to be reduced significantly in a number of areas so as to increase environmental flows in rivers and wetlands and ensure that levels of groundwater extraction are sustainable.

These proposed and actual legislative and administrative changes have been vehemently opposed by a number of farm lobby groups, particularly the National Farmers Federation and Agforce Queensland. They argue that these changes constitute an unjust restriction on farmers' property rights and that farmers should not be forced to shoulder the burden of providing environmental public goods for the broader community (National Farmers Federation 2002; National Farmers Federation 2003a; Agforce Queensland 2003). Consequently, to address these issues, farm lobby groups are seeking to ensure farmers have a legal right to compensation when their property rights in land and water are restricted or extinguished for environmental purposes (National Farmers Federation 2002; Queensland Farmers Federation 2003; Agforce Queensland 2003).

The Howard Government has been keen to be seen to support the calls for farmers to be provided with a statutory right to compensation. The Deputy Prime Minister, John Anderson, for example, has stated:

[T]he best way to protect our land and water resources is to create a system of secure environmental property rights. ... The Government believes that landholders who give up property rights in the interests of the environment should receive proper compensation or adjustment assistance. The property rights approach can be extended beyond water flows to other policy areas, including the protection of vegetation and biodiversity. ... Compensation is strictly a matter for the states and territories, but we are committed to ensuring that they provide fair compensation when rights are lost, and there is a transfer of farm equity from landholders to the broader community for environmental purposes (Anderson 2002).

In recent times, two events have raised the profile of the question of whether farmers should have a legal right to compensation when their property rights are restricted or extinguished for environmental purposes. Firstly, at the Council of Australian Governments' (COAG) meeting in June 2004, the Commonwealth and the Governments of New South Wales, Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory signed the Intergovernmental Agreement on a National Water Initiative (the National Water Initiative), which aims to restructure the framework for water management in the relevant jurisdictions. A critical element of the National Water Initiative is the requirement for these state and territory governments to provide irrigators with a statutory right to compensation when their water entitlements are reduced in certain circumstances.

Secondly, in April 2003 the Federal Treasurer directed the Productivity Commission to undertake a review of the financial impacts of native vegetation and biodiversity laws on farmers and the appropriateness of the current distribution of costs for preventing environmental degradation. The Commission's final report was released in August 2004 (Productivity Commission 2004) and was welcomed by farm lobby groups as supposedly supporting their claims for a statutory right to compensation where farmers' property rights in land and water resources are restricted for public good environmental purposes (Day 2004). Despite the enthusiastic response by farm lobby groups, the Commission's position on the creation of a statutory right to compensation is unclear. The report does, however, support the notion that public good environmental benefits associated with the retention of native vegetation should be purchased from landholders. It is likely that a statutory right to compensation for the impacts of some native vegetation and biodiversity laws that are designed to achieve 'public good environmental benefits' could fit within the framework envisaged by the Productivity Commission.

This paper seeks to explain the nature of property rights, evaluate the property rights debate as it relates to agriculture in Australia, and analyse whether farmers should be provided with additional rights to compensation when their property rights in land and water are restricted or extinguished for environmental purposes. The paper is set out as follows:

- Section 2 discusses the meaning of the phrase 'property rights' as it is used in the so-called property rights debate;
- Section 3 outlines precisely what the farm lobby groups are seeking, what the Productivity Commission has proposed and what rights to compensation farmers will receive under the National Water Initiative;
- Section 4 analyses the interests farmers currently have in land and water resources;
- Section 5 reviews the existing frameworks for the payment of compensation to farmers whose property rights are restricted or extinguished;
- Section 6 looks at the justifications for restrictions on farmers' property rights in land and water so as to provide a context in which to analyse whether additional rights to compensation are warranted;
- Section 7 examines whether the creation of additional legal rights to compensation will have a positive or negative impact on economic efficiency;
- Section 8 analyses whether the creation of additional legal rights to compensation is equitable; and
- Section 9 provides some conclusions and recommendations.

2. What are property rights?

The debate about the provision of compensation to farmers whose rights or interests concerning property have been restricted or extinguished by the state has been complicated by the fact that there are a number of different meanings of the phrase 'property rights'. Therefore, before discussing the policy question of whether farmers should have a legal right to compensation, it is worthwhile clarifying what the phrase 'property rights' actually means. To do so, it is necessary to review some fundamental principles about property.

In environmental debates, the term 'property' is often used to describe physical resources such as land, forests, fisheries or water. However, it should be remembered that property includes anything that is capable of being owned. It can include tangible items, such as land or a car, and intangible items, such as copyright in a book or the legal right to sue a person for negligence.

Confusion can also arise due to the fact that, when used in a legal context, 'property' can either refer to the rights or interest a person holds in respect of a tangible or intangible item, or the tangible or intangible item itself. This can be demonstrated by the case of land, where it is common for a person to refer to a parcel of land as being their property. Yet, from a legal perspective, the Crown is the ultimate owner of the land. What the person owns is an estate or interest in the land, not the land itself. As Latham CJ stated in *Minister for State for the Army v Dalziel*:

It has often been explained by writers upon jurisprudence that the term 'property' is ambiguous. As applied to land it may mean the land itself in relation to which rights of ownership exist, or it may refer to the rights of ownership which exist in relation to the land.¹

It should also be remembered that in a legal context, a right is an interest that is protected by law, such that there is a duty on others not to interfere with the enjoyment of the benefits associated with the interest. If there is no duty not to interfere with the enjoyment of the interest, there is no legal right. This concept is encapsulated in the following extract from Oliver Wendell Holmes Jr's *The Common Law* (1882), which was quoted with approval by McHugh J in *Yanner v Eaton*:

The law [of property] does not enable me to use or abuse this book which lies before me. That is a physical power which I have without the aid of the law. What the law does is simply to prevent other men to a greater or less extent from interfering with my use or abuse.²

This aspect of legal rights has led some commentators to point out that the restriction on certain uses of land does not constitute the taking of a proprietary right, but rather the confiscation of a privilege associated with a person's interest in real property (Grafton 2003).³ While this is correct in law, it is not correct in the context in which

¹ (1944) 68 CLR 261.

² [1999] HCA 53, at [49].

³ See also, *Yanner v Eaton* [1999] HCA 53 at [74], per Gummow J in relation to rights and privileges concerning native title.

the phrase ‘property rights’ is used in the public debate concerning farmers’ interests in land and water resources.

The legal concept of property is made more complex by two factors. Firstly, a right or interest concerning a tangible or intangible item will not always constitute property for legal purposes. This issue was explained by Lord Wilberforce in *National Provincial Bank Ltd. v. Ainsworth*⁴, where he stated:

Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability.

Therefore, a right may not qualify as a proprietary right if it cannot be assigned or transferred and is not permanent, definable and identifiable by third parties.⁵ For example, a personal right under a licence may not be property for legal purposes. This was the case in *Reg. v. Toohey; Ex parte Meneling Station Pty Ltd*,⁶ where the High Court held that a grazing lease did not amount to property, or more accurately, the holder of the licence did not have an ‘estate or interest’ in the land. This decision was consistent with the long established principle that a mere licence does not create an estate or interest in the property to which it relates, it only ‘makes an act lawful which without it would be unlawful’.⁷

The second issue that complicates the legal concept of property is the meaning the High Court has given to the term ‘property’ in section 51(xxxi) of the Commonwealth Constitution. Section 51(xxxi) states:

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to ... the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws.

The meaning of ‘property’ in section 51(xxxi) has always been a source of conjecture and, as Kirby J stated in *Newcrest Mining (WA) Ltd v Commonwealth*,⁸ there are ‘serious problems’ that still need to be resolved about the operation of this clause. However, what is clear from the existing case law is that ‘property’ in this context extends beyond the formal estates and interests recognised under the principles of property law. As Dixon J stated in *Bank of NSW v Commonwealth*:

⁴ (1965) AC 1175, at pp.1247-1248.

⁵ It is now generally accepted that assignability is not an essential characteristic of a proprietary right. However, it is a relevant factor in determining whether a right is of a proprietary nature. As Brennan J explained in *Australian Capital Television Pty Ltd v Commonwealth* (1992) 177 CLR 106, ‘the want of assignability of a right is a factor tending against the characterization of a right as property’ but it is not a test of a proprietary right. See also *Commissioner of Stamp Duties (NSW) v. Yeend* (1929) 43 CLR 235, per Isaacs J; *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297, per Brennan J; *Reg. v. Toohey; Ex parte Meneling Station Pty Ltd* (1982) 158 CLR 327, per Mason J; and *Yanner v Eaton* (1999) 201 CLR 351, per Gummow J.

⁶ (1982) 158 CLR 327.

⁷ *Thomas v Sorrell* (1673) 124 ER 1098 at 1109. See also, *Banks v Transport Regulation Board (Vic)* (1968) 119 CLR 222, per Barwick CJ; and *Minister of State for the Army v Dalziel* (1944) 68 CLR 261.

⁸ (1997) 190 CLR 513.

... s.51 (xxxii) is not to be confined pedantically to the taking of title by the Commonwealth to some specific estate or interest in land recognized at law or in equity and to some specific form of property in a chattel or chose in action similarly recognized, but that it extends to innominate and anomalous interests and includes the assumption and indefinite continuance of exclusive possession and control for the purposes of the Commonwealth of any subject of property.⁹

Where the boundaries of the phrase ‘innominate and anomalous interests’ lie is unclear. Some have suggested the interest must be of a ‘proprietary nature’.¹⁰ However, it now appears to be accepted that property for these purposes extends beyond formal estates and interests recognised under the principles of property law and includes other ‘benefits and advantages’ concerning property.¹¹ As Callinan J stated in *Smith v ANL Limited*:

... what has been acquired may often be without any analogue in the law of property and incapable of characterisation according to any established principles of property law.¹²

In summary, there are several distinct legal meanings of property which can create considerable confusion when seeking to answer the policy questions concerning the payment of compensation. As Gummow J has observed, the term property is a ‘striking example of the inherent ambiguity and looseness in legal terminology’.¹³

What then does the phrase ‘property rights’ mean when it is used in the context of the debate over whether compensation should be payable to farmers whose rights or interests concerning land and water have been restricted or extinguished by a government?

Generally, when used in this context, the phrase ‘property rights’ is not intended to be restricted to the legal definition of a proprietary right or a formal interest or estate in property recognised under the general principles of property law. Rather, it is intended to refer to the collection of socially and legally constructed rights and obligations that determine how land and other resources are used. This notion is encapsulated in the following quote from a staff research paper published by the Productivity Commission in 2001.

Property rights comprise the bundle of ownership, use and entitlement rights that a user has over a good or resource such as land, and include any responsibilities that the user may have to others. Entitlements may include the right to grow crops and develop land. Responsibilities may include using the land in a specified way (such as grazing on pastoral lease land) or refraining

⁹ (1948) 76 CLR 1 at 349.

¹⁰ See *Australian Capital Television Pty. Ltd. v. Commonwealth* (1992) 177 CLR 106, per Brennan J; *Australian Tape Manufacturers Association Ltd v Commonwealth* (1993) 176 CLR 480, per Dawson and Toohey JJ; *Georgiadis v Australian and Overseas Telecommunications Corporation Ltd* (1994) 179 CLR 297, per Brennan J, Dawson J and Toohey J.

¹¹ *Smith v ANL Ltd* (2000) 204 CLR 493; *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1; and *Mutual Pools & Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155.

¹² [2000] HCA 58 at [157].

¹³ *Yanner v Eaton* [1999] HCA 53 at [85].

from activities or practices that interfere with the activities or enjoyment of others. As such, property rights govern access to resources and reflect the community's expectations about what resources uses are acceptable (Aretino *et al.* 2001, p. 11).

In this context, the phrase 'property rights' is not a legal but an economic term that is intended to describe the broad collection of legal and social arrangements that govern access and use of a society's resources. What may constitute a mere privilege of ownership at law may, in this context, fall within the definition of a property right. So, for example, the ability of a landholder to clear native vegetation without the need to obtain approval from the state is not a right at law; it is a mere privilege associated with the particular title the person holds in the parcel of land. However, to economists and others involved in the property rights debate, this legal privilege is a property right.

Therefore, when farm lobby groups talk of farmers' property rights being taken away or being expropriated for the benefit of the broader community, they are referring to the loss of the ability to determine how a particular resource is used (or, in the case of water, how much, when and how it is used), not necessarily the formal loss of a right that is protected under law.

Importantly, as 'property rights' in this context are a social construct, they are constantly changing to reflect the shifting values and norms of our community. Whether these rights are reflected in law is another question and, indeed, is a central issue in the property rights debate.

3. What do the farm lobby groups want?

Farm lobby groups argue that changes to federal and state environmental and water laws over the past decade have eroded farmers' property rights in land and water and that this has had numerous adverse consequences. The changes have:

- prevented productive activities from being undertaken in rural areas;
- increased uncertainty associated with agricultural activities;
- forced landholders to incur large compliance costs;
- hindered the ability of farmers to adapt to seasonal variations and economic pressures because of the delay and expense associated with complying with the laws;
- reduced the value of agricultural land;
- decreased the potential for farmers to access capital for agricultural activities;
- decreased agricultural productivity and economic growth in rural areas and, as a result, farm businesses have declined, as has the population in rural areas;
- created incentives to degrade the environment (for example, a farmer may clear native vegetation before clearing laws commence, as happened in Queensland prior to the commencement of the *Vegetation Management Act 1999* (Qld)) and prevented the adoption of appropriate land management practices (for example, it has stopped landholders from managing woody weeds); and
- adversely affected the health of farmers and their dependents due to the financial impacts and uncertainty associated with the new laws (National Farmers Federation 2002; National Farmers Federation 2003a; South Australian Farmers Federation 2003; Western Australia Farmers Federation 2003; and Agforce Queensland 2003).

Partly to address these issues, farm lobby groups are demanding that governments provide farmers with a statutory right to compensation if their property rights in land and water resources are abrogated for environmental purposes. Broadly, they contend that farmers' property rights include the right to determine how 'their' land and water resources are used, free from government interference. As discussed, as the law currently stands, the ability of a farmer to determine how land and water resources are used is a privilege, not a right. Consequently, from a legal perspective, farm lobby groups are essentially seeking to upgrade this privilege to a formal legal right so that if the government wants to interfere with farmers' use and enjoyment of their land and water resources, it will have to compensate them for doing so (National Farmers Federation 2002; National Farmers Federation 2003a; South Australian Farmers Federation 2003; Western Australia Farmers Federation 2003; and Agforce Queensland 2003). At its most extreme, the request roughly equates to a claim for absolute ownership of all agricultural land and the water resources farmers currently

use. However, most farm lobby groups have indicated a willingness to accept some restrictions on farmers' rights of ownership or control.

While there are differences of opinion amongst the groups, it appears the most widely held view is that farmers should be compensated for restrictions on their property rights that are designed to deliver benefits to the community as a whole (or what are sometimes called 'public good environmental benefits') (National Farmers Federation 2002; Queensland Farmers Federation 2003). That is, they are willing to accept the costs associated with restrictions that are designed to deliver private environmental benefits, but not those intended to achieve public good outcomes. As the Queensland Farmers Federation has stated:

Ecological sustainable management serves the public interest as well as the landholder's private interest. Where such management is in the public interest, especially, but not solely, where this is at the expense of the landholder's private interest, the actions should and must attract an incentive or a form of adjustment if the landholder's private interests have been encroached upon significantly (Queensland Farmers Federation 2003, p. 9).

The Productivity Commission's position on the creation of a statutory right to compensation for the impacts of native vegetation and biodiversity laws on farmers' property rights is unclear. In the report released in August 2004, the Commission rejected the notion that farmers should necessarily be compensated for the impacts of existing native vegetation and biodiversity laws (Productivity Commission 2004). In this regard, the Commission stated:

... the Commission does not recommend simply compensating landholders for the impacts of existing compulsory regulatory regimes. This is not only because of the numerous difficulties in assessing appropriate farm-level compensation ... but because continued reliance on regulation to achieve a range of broadly-defined environmental goals appears unlikely to be the most effective, least cost option from a whole-of-community perspective. In this case, compensation would merely shift an unnecessarily large cost burden from landholders to taxpayers (Productivity Commission 2004, p. 225).

As this extract suggests, the Commission's apparent opposition to the payment of compensation for the impacts of existing native vegetation and biodiversity laws forms part of a broader critique of the current regulatory framework. It is advocating a major overhaul of existing native vegetation and biodiversity laws so as to devolve greater responsibility to regional bodies and lessen the emphasis on regulation to achieve environmental outcomes. An essential part of the Commission's proposed framework is that farmers should be required to 'bear the costs of actions that directly contribute to sustainable resource use', while the costs of providing public good environmental benefits should be borne by taxpayers (Productivity Commission 2004, p. 230). As it states:

In the Commission's assessment, the wider public should bear the costs of retaining and managing native vegetation to promote 'public good' environmental services – such as biodiversity, habitat preservation and greenhouse gas abatement – that it apparently demands, and which are likely

to impinge significantly on the capacity of landholders to utilise their land for production (Productivity Commission 2004, p. XLI).

While the Commission clearly sees regulation as a poor substitute for alternative policy mechanisms (mainly voluntary measures), it does acknowledge that regulation may be necessary and cost effective in certain circumstances. Where regulation is used to achieve public good environmental outcomes, the Commission suggests compensation may have to be paid to affected farmers.

[I]f a transfer of rights implied by a regulatory rule is considered to be efficient, this does not preclude the payment of compensation to the landholders affected. The efficiency of regulation should not rest on the uncompensated transfer of long-accepted – and bought – rights (Productivity Commission 2004, p. 233).

Although silent on the point, the creation of a statutory right to compensation for the impacts of some native vegetation and biodiversity laws that are designed to achieve public good environmental benefits could fit within the framework envisaged by the Commission. The most obvious difficulty, however, would be determining what constitutes ‘public good environmental benefits’ for these purposes. It is impossible to specify a distinct line between private and public benefits derived from the conservation or restoration of a particular aspect of the environment. However, the Commission appears to suggest ‘public good environmental benefits’ should be those that are over and above the environmental objectives that are identified by regional management committees as being necessary for sustainable resource use.¹⁴ Hence, a statutory right to compensation could apply to restrictions on property rights that are imposed under native vegetation and biodiversity laws that are additional to the restrictions applied by regional management committees.

The Productivity Commission report was welcomed by farm lobby groups (Day 2004). The National Farmers Federation even suggested the report supported its calls for a national framework to provide farmers with a statutory right to compensation for the impacts of native vegetation and biodiversity laws. It stated:

Today’s release of the Productivity Commission’s Inquiry into the Impacts of Native Vegetation and Biodiversity Regulations provides overwhelming evidence to support the National Farmers’ Federation call for governments to provide farmers with security over their land and native vegetation resources through a robust and clear national framework.¹⁵

As discussed, the Productivity Commission (2004) report does not support the provision of compensation for the impacts of the existing native vegetation and biodiversity laws, nor does it explicitly advocate for the creation of a statutory right to compensation in relation to future laws. However, farm lobby groups are obviously viewing the release of the report as an opportunity to press their case for the creation of a right to compensation for the impacts of native vegetation and biodiversity laws on farmers’ property rights in land.

¹⁴ See Chapter 10, particularly Recommendation 10.9.

¹⁵ National Farmers Federation, *Farmers’ Calls for a National Framework for Land and Native Vegetation Justified*, Press Release, 10 August 2004.

The National Water Initiative requires the governments of New South Wales, Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory to modify their water laws so as to provide farmers with a legal right to compensation for certain reductions in water allocations.¹⁶ The main elements of the compensation or risk allocation framework proposed under the National Water Initiative are as follows.

- Farmers have no right to compensation for reductions in water allocations arising from steps to address known over-allocated and/or overused systems.¹⁷ The ‘known’ over-allocated and overused systems referred to in the relevant provisions in the National Water Initiative appear to relate to the over-allocated and stressed systems identified in the individual implementation programs submitted to the National Competition Council by the states and territories (see clauses 41 and 42) and to systems that are found to be over-allocated and/or overused in water planning processes undertaken by the states and territories up until 2014 (see clauses 26, 36, 43, 44, 45, 49 and 97).
- There are two instances where the National Water Initiative requires farmers to be compensated for reductions in water allocations that are over and above those that are specified as being necessary to address ‘known over-allocation and/or overuse’.¹⁸ Firstly, farmers will have a right to compensation where water allocations are reduced by greater than three per cent in a ten year period under a water plan that commenced or was renewed after 2014 ‘as a result of bona fide improvements in the knowledge of water systems’ capacity to sustain particular extraction levels’.¹⁹ Secondly, farmers will be provided with a right to compensation for reductions in water allocations that are not previously provided for and that arise from changes in government policy (for example, the specification of new environmental objectives in a water management plan).²⁰

While farmers will be entitled to receive compensation for reductions in allocations that occur in these circumstances, the National Water Initiative explicitly provides that farmers will not have a statutory right to compensation for ‘reduction or less reliable water allocation ... arising from reductions to the

¹⁶ Clause 27.

¹⁷ Clauses 41-46. Although the National Water Initiative does not require compensation to be provided to farmers for reductions in water entitlements that arise as a result of attempts to address ‘known over-allocation and/or overuse’, the relevant states and territories are required to consider the risk assignment framework in clauses 46 to 51 when addressing adjustment issues associated with reductions in water availability (see clause 97).

¹⁸ See clauses 46-51.

¹⁹ Clause 49.

²⁰ Clause 50. There is some uncertainty regarding when these compensation triggers will apply. Their precise nature will not be clear until they have been incorporated into the laws of the relevant jurisdictions. However, when read in the context of the planning and management provisions in the National Water Initiative, it appears likely the first of these compensation ‘triggers’ broadly relates to circumstances where farmers’ allocations are reduced as a result of the realisation that the environmental objectives (or possibly only key environmental objectives) specified in the relevant water management plans will not be met unless cuts are made to consumptive allocations (see clauses 25-40, 47, 78 and 79). The second appears to relate to reductions that arise from any changes in environmental and other public benefit outcomes specified in the relevant water management plans.

consumptive pool as a result of ... (i) seasonal or long-term changes in climate; and (ii) periodic natural events such as bushfires and drought'.²¹

Although this proposal does not go as far as some farm lobby groups initially wanted and falls short of absolute ownership, it appears that most of them are happy with the outcome.²² The National Farmers Federation, for example, described it as a 'significant win for Australian farmers' and said that it 'will have a significant and beneficial long-term impact on farming communities and the environment'.²³

To assist in evaluating the merits of the compensation framework proposed under the National Water Initiative, the suggestions of the Productivity Commission, and the requests of farmer lobby groups, the following section looks at the interests farmers currently have in land and water resources.

²¹ Clause 48.

²² National Farmers Federation, *COAG Decision a Victory for NFF*, Press Release, 25 June 2004; NSW Farmers Association, *A Major Milestone for Agriculture*, Press Release, 25 June 2004; and Queensland Farmers Federation, *Farmers Welcome Historic Water Initiative*, Press Release, 25 June 2004.

²³ National Farmers Federation, *COAG Decision a Victory for NFF*, Press Release, 25 June 2004.

4. Farmers' interests in land and water resources

The starting point for any discussion about whether a person should be provided with compensation for restrictions on their property rights is to determine the nature of their interest in the relevant property.

Farmers generally have one of three different types of interest in land: freehold title, leasehold title or a mere licence. Freehold and leasehold title give the holder a proprietary interest in the subject land. By contrast, the holder of a licence merely has a personal right that relates to the land.²⁴ However, irrespective of whether they hold a freehold interest, leasehold interest or a licence, the farmer is never the ultimate owner of the land. The government is the ultimate owner in the sense that it holds 'radical title' and a farmer's interest in the land is held 'of the Crown' (Smith 2002). This is the basis of the doctrine of tenure that underpins Australia's system of land law. Upon assuming sovereignty, the Crown acquired radical title to the land and was therefore able to 'grant an interest in land to be held of the Crown or to acquire land for the Crown's demesne'.²⁵ Hence, farmers' interests in land, even those that hold freehold title, are subject to the Crown's underlying interest or 'paramount estate' in the land.²⁶

Although farmers are never the ultimate owners of any land in a legal sense, it is commonly believed that a freehold interest equates to ownership, even possibly absolute ownership. This is important, as social attitudes play a crucial role in determining farmers' property rights. Yet, the notion that freehold title constitutes absolute ownership is a serious misconception as the vast majority of land, if not all, held under freehold title is subject to legal restrictions of some description. For example, the fact that a person may 'own' land under freehold title does not mean they can build whatever they want on it or use it for any purpose. Generally, a landholder will be required to obtain government approval before undertaking any substantial development on their land, particularly if the land is located in an urban area. Even if it is accepted that freehold title roughly equates to absolute ownership, an argument that clearly conflicts with the current reality, it is widely accepted that an interest in land under a lease or licence is less than absolute. Very few people would agree that a lessor does not have the right to place restrictions on how a lessee uses the subject land. For example, people with a residential lease typically need the permission of the owner to paint or renovate the property. The same can be said of land occupied under a licence.

The situation with respect to farmers' interests in water is similar to those concerning their interests in land. While there are differences between jurisdictions, it is generally the case that state and territory governments 'own' the freshwater resources within

²⁴ Whether a grant constitutes a leasehold interest or a mere licence will depend on the nature of the grant, not the name ascribed to it. Therefore, a farmer that holds what is called a lease, may in fact only hold a licence that gives him/her no proprietary interest in the land.

²⁵ *Mabo v Queensland [No.2]* (1992) 175 CLR 1 at 48-49, per Brennan J.

²⁶ *Commonwealth v Yarmirr* [2001] HCA 56 at [47], per Gleeson CJ, Gaudron, Gummow and Hayne JJ.

their borders. At the very least, the states and territories control the use and development of freshwater resources through various pieces of legislation.²⁷

Irrigators' rights to access and use water is primarily derived from licences granted by the state and territory governments, which entitle them to extract a certain quantity of water from a particular water source (whether it is a river, lake, aquifer or dam storage) and to use it for a specified purpose.²⁸ As discussed above, rights under a licence may not constitute property at law, but rather merely a person right. Hence, the rights under a water licence may merely make 'an act lawful which without it would be unlawful'.²⁹ Yet, from an economic perspective, and from the perspective of s.51(xxxi) of the Commonwealth Constitution, there is no doubt that rights under a water licence are property rights.³⁰

Historically, the nature of farmers' rights under water licences has varied considerably between jurisdictions. However, efforts have been made over the last decade to create a more uniform set of water rights for irrigators. The first large step in this process was the signing of the COAG Water Reform Framework in February 1994. Its primary purpose was to create an institutional framework that would aid the development of efficient markets for water rights, based on the theory that if efficient water markets could be created, it would result in water being directed to the most economically efficient and profitable uses (Bond and Farrier 1996; Melville and Broughton 2004). To achieve this, the Water Reform Framework sought to separate water entitlements from land, create greater certainty and uniformity in water entitlements, and break down barriers to intra- and inter-jurisdictional water trades.³¹

²⁷ For discussion on the nature of the Crown's interest in water resources, see *Hanson v Grassy Gold Mining Co.* (1900) 21 NSWLR 271; *Thorpes Ltd v Grant Pastoral Co. Pty Ltd* (1955) 92 CLR 317; and *Yanner v Eaton* (1999) 201 CLR 351, per Gleeson CJ, Gaudron, Kirby and Hayne JJ. It is interesting to note that clause 27 of the National Water Initiative states that the relevant states and territories 'retain the vested rights to the use, flow and control of water'.

²⁸ This is a simplification of a complex area of law. At common law, a landholder's water rights could be divided into two categories: riparian rights (i.e. rights relating to water flowing in a watercourse); and non-riparian rights (which relate to rights to water in aquifers and running across the surface of the land). The riparian rights of a landholder were confined to the right 'to have the water of the stream, on the banks of which his property lies, flow down as it has been accustomed to flow down to his property, subject to the ordinary use of the flowing water by upper proprietors, and to such further use, if any, on their part in connection with their property as may be reasonable under the circumstances' (*H. Jones & Co. Pty Ltd v Kingborough Corporation* (1950) 82 CLR 282, per Latham CJ). Around the time of Federation, these rights were reduced significantly by the enactment of water legislation. However, in some jurisdictions, landholders may have certain residual riparian rights, including the right to use the water of a river or lake for domestic purposes (for further discussion, see *Hanson v Grassy Gold Mining Co.* (1900) 21 NSWLR 271; *Thorpes Ltd v Grant Pastoral Co. Pty Ltd* (1955) 92 CLR 317; and Bond and Farrier (1996)). A landholder's common law non-riparian rights were the right to use, collect and control water flowing over the surface of the land and the unrestricted right to extract water under the land (although, in England, this is now constrained by the law of nuisance). Again, these non-riparian rights have largely been abolished by statute (for discussion, see *Cambridge Water Co. v Eastern Counties Leather PLC* [1994] 2 AC 264; Tan (2002); and Doyle (2001)).

²⁹ See *Thomas v Sorrell* (1673) 124 ER 1098 at 1109; *Banks v Transport Regulation Board (Vic)* (1968) 119 CLR 222, per Barwick CJ; *Minister of State for the Army v Dalziel* (1944) 68 CLR 261; and Bell (2001).

³⁰ See *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1.

³¹ For discussion on the implementation of the Water Reform Framework, see National Competition Council (2003) and Munro (2004).

The National Water Initiative is designed to build on the Water Reform Framework and is supposed to continue the process of creating efficient water markets. The proposal to create a statutory right to compensation for reductions in water entitlements is claimed to be vital to the establishment of efficient water markets as it is argued the right to compensation will provide farmers with the necessary level of security and certainty to engage in water trading and to invest in water infrastructure (Munro 2004; ACIL Tasman 2004; Commonwealth Department of the Prime Minister and Cabinet 2004).

The push to provide farmers with a statutory right to compensation contrasts with the apparent hesitancy to adopt full cost recovery principles in water pricing. The National Water Initiative merely provides that the relevant states and territories will 'continue to examine the feasibility of using market based mechanisms such as pricing to account for positive and negative externalities associated with water use' and 'implement pricing that includes externalities where found to be feasible'.³² It also explicitly recognises that full cost recovery water pricing is unachievable for 'some community services that will never be economically viable' in rural and regional areas.³³ The absence of firm commitments to ensure full cost recovery water pricing that includes environmental externalities corresponds with farm lobby groups' opposition to the application of market principles to all aspects of the water management framework. As the National Farmers Federation has stated succinctly:

NFF does not support the inclusion of environmental impact as part of best practice pricing. ... Water pricing must not be used as a policy instrument for delivering environmental outcomes or modifying the behaviour of water users (National Farmers Federation 2003b, p. 1).

Without full cost recovery pricing, the prospects of establishing efficient water markets are significantly reduced. Hence, it is arguable that the farm lobby groups and possibly also the signatories to the National Water Initiative are not, in truth, seeking to establish efficient water markets, but rather an outcome that meets other social and political objectives.

Even so, the absence of full cost recovery pricing does not necessarily mean that the creation of a statutory right to compensation will have an adverse impact on net social welfare. Therefore, having clarified the nature of farmers' interests in land and water resources, the next section looks at the existing frameworks for the payment of compensation as a result of restrictions on property rights in land and water resources.

³² Clause 73.

³³ Clause 66.

5. The existing compensation framework

This section reviews the existing frameworks for the payment of compensation when farmers' property rights in land and water resources are restricted or extinguished under laws passed by federal, state and territory governments. Section 5.1 examines the requirements in the Australian Constitution concerning the acquisition of property and analyses whether farmers already have a right to compensation for the impacts of federal and territory environmental laws. Section 5.2 considers whether the states have a constitutional obligation to compensate farmers when they restrict their property rights and briefly reviews how state governments have dealt with compensation issues in the past.

5.1 The Commonwealth and territory governments

As discussed above, section 51(xxxi) of the Australian Constitution provides the Commonwealth with a power to make laws for the 'acquisition of property on just terms from any state or person for any purpose in respect of which the Parliament has power to make laws'. This provision performs two purposes.³⁴ Firstly, it provides the Commonwealth with the power to acquire property. Secondly, it serves as a constitutional guarantee that the Commonwealth (and through it, the territory governments) cannot acquire a person's property without providing just terms.³⁵ As Dixon J has explained:

It provides the Commonwealth Parliament with a legislative power of acquiring property: at the same time as a condition upon the exercise of the power it provides the individual or the State, affected with a protection against governmental interferences with his proprietary rights without just recompense.³⁶

Farm lobby groups are calling on the Commonwealth to ensure that compensation is payable when federal and territory environmental laws curtail farmers' property rights in land and water resources. Yet, it is arguable s.51(xxxi) of the Constitution already provides farmers with this right, at least in relation to environmental laws that prevent a farmer's land or water entitlements from being used for any viable commercial purpose.

In *Commonwealth v Tasmania*³⁷ (the 'Tasmanian Dams Case'), three members of the Court (Mason, Brennan and Murphy JJ) held that federal laws requiring ministerial approval for certain uses of land did not affect an acquisition of property.³⁸ Consequently, it has been argued that federal laws imposing land use restrictions do

³⁴ See, for example, *Smith v ANL Ltd* (2000) 204 CLR 493; *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1; *Commonwealth v Mewett* (1997) 146 ALR 299; *Newcrest Mining (WA) Ltd v Commonwealth* (1997) 190 CLR 513; and *Commonwealth v Western Australia* (1999) 196 CLR 392.

³⁵ The High Court has held that the power to make laws for the government of the territories in s.122 of the Constitution is subject to the restrictions in s.51(xxxi) (*Newcrest Mining (WA) Ltd v Commonwealth* (1997) 190 CLR 513). See also *Australian Capital Territory (Self-Government) Act 1988*, s.23(1) and *Northern Territory (Self-Government) Act 1978*, s.50.

³⁶ *Bank of NSW v Commonwealth* (1948) 76 CLR 1 at 349.

³⁷ [1983] HCA 21; (1983) 158 CLR 1.

³⁸ Deane J held that certain aspects of the laws did result in an acquisition of property (see *Commonwealth v Tasmania* [1983] HCA 21 at [81] – [85], per Deane J).

not trigger the ‘just terms’ requirement in s.51(xxxi) (Sperling 1997; Smith 2002). However, a number of High Court decisions in the 1990s and early 2000s have cast considerable doubt on the weight of this authority.³⁹

There is now a strong argument that restrictions imposed on the use of farmers’ land and water entitlements under Commonwealth and territory biodiversity laws such as the *Environment Protection and Biodiversity Conservation Act 1999* (Cwlth) (EPBC Act) may bring about an ‘acquisition of property’ for the purposes of s.51(xxxi) in certain circumstances.⁴⁰ Of particular note is the High Court’s decision in *Newcrest Mining (WA) Ltd v Commonwealth*⁴¹, where the Court held that laws preventing the exercise of rights under mining leases brought about an acquisition of property, notwithstanding that the laws did not result in any person obtaining a formal proprietary interest in the subject land. All the Commonwealth acquired was the benefit of a release from the burden of the mining leases.

In a number of more recent cases, several members of the High Court have signalled a willingness to broaden the scope of the guarantee in s.51(xxxi) in relation to laws that impose restrictions on the use and enjoyment of interests in land. The most notable of these are the judgements of Callinan J and Kirby J in *Smith v ANL Ltd*⁴² and *Commonwealth v Western Australia*.⁴³ In *Smith v ANL Ltd*, for example, Callinan J stated:

I do not myself discern in that passage from the judgement of Dixon J, any express, or indeed implied, support for the narrow view which Mason J took of the provision in The Tasmanian Dam Case, or, for the attachment of any great significance to any distinction between a taking or an acquisition, whether perceived or actual. ... In any event, in my respectful opinion, in the Tasmanian Dams Case, it is easy to see that the Commonwealth really did

³⁹ In particular, see *Newcrest Mining (WA) Ltd v Commonwealth* (1997) 190 CLR 513; *Commonwealth v Western Australia* (1999) 196 CLR 392; *Smith v ANL Ltd* (2000) 204 CLR 493; and *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1. See also *Airservices Australia v Canadian Airlines International Ltd* (1999) 74 ALJR 76; *Commonwealth v Mewett* (1997) 146 ALR 299; *Mutual Pools and Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155; *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297; *Nintendo Company Ltd v Centronics Systems Pty Ltd* (1994) 181 CLR 134; *Re Director of Public Prosecutions; Ex Parte Lawler* (1994) 179 CLR 270; *Health Insurance Commission v Peverill* (1994) 179 CLR 226; and *Australian Tape Manufacturers Association Ltd v Commonwealth* (1993) 176 CLR 480.

⁴⁰ It must be emphasised, however, that where a farmer holds water entitlements in either the Australian Capital Territory or the Northern Territory, it is unlikely they will be entitled to compensation under s.51(xxxi) of the Constitution for reductions in their allocations that are made in accordance with the laws that created the relevant legal rights. As these rights are the creation of statute not general law, they will usually be inherently susceptible to variation under the legislative scheme that created them (See *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1; *Health Insurance Commission v Peverill* (1994) 179 CLR 226; *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297; and *Minister for Primary Industry and Energy v Davey* (1993) 119 ALR 108). Yet, as noted in Section 3, both the Australian Capital Territory and the Northern Territory are signatories to the National Water Initiative. Hence, it appears they intend to grant farmers a qualified statutory right to compensation where their water entitlements are reduced in certain circumstances.

⁴¹ (1997) 190 CLR 513.

⁴² (2000) 204 CLR 493; [2000] HCA 58.

⁴³ (1999) 196 CLR 392; [1999] HCA 5. See also, *Airservices Australia v Canadian Airlines International Ltd* (1999) 74 ALJR 76, per Callinan J.

acquire something, and that was a thing of immense value, the right to control virtually absolutely the use to which the area in question would be put.⁴⁴

At least two other members of the current High Court (Gleeson CJ and Gummow J) have also made statements that are consistent with the conclusion that laws that regulate the use of land and water resources, such as the EPBC Act, can bring about an acquisition of property.⁴⁵

The Howard Government was clearly aware of this fact when drafting the EPBC Act. In this regard, s.519 of the EPBC Act provides that where the operation of the Act would result in an acquisition of property from a person for the purpose of s.51(xxxi) of the Constitution, the ‘Commonwealth must pay the person a reasonable amount of compensation’. This section also enables a person from whom property is acquired to apply to the Federal Court for the recovery of compensation in these circumstances.

Given the developments in relation to the meaning of s.51(xxxi), the vocal opposition of farm lobby groups to the EPBC Act and the rights contained in s.519 of the Act, it is curious that no farm lobby group has attempted to establish a test case concerning the payment of compensation for an acquisition of property caused by the operation of the Act. Similarly, it is interesting that the Government has not made a substantive effort, at least not publicly, to make farmers aware of this possibility. Yet, this may be explained by the fact that in the four years since the EPBC Act commenced, only two applications for approval to take an action have been refused and only one person has successfully been prosecuted for failing to comply with the referral, assessment and approval provisions in the Act.⁴⁶

In summary, whether farmers have a constitutional right to compensation when their property rights are restricted by the Federal Government or a territory government is dependent on the question of whether the restrictions constitute an ‘acquisition of property’ for the purposes of s.51(xxxi) of the Constitution. Although there is

⁴⁴ [2000] HCA 58 at [166]. Callinan J has, however, expressed caution about the extent to which planning and other similar laws will bring about an acquisition of property for the purpose of s.51(xxxi). In this regard, he has suggested ‘town planning and other special or like powers which may require separate consideration’ (*Commonwealth v Western Australia* [1999] HCA 5 at [280], per Callinan J). It is arguable that many environmental laws are similar to planning laws and, as such, should be given greater scope within which to abrogate property rights without affecting an ‘acquisition of property’. See also, *Commonwealth v Tasmania* [1983] HCA 21 at [73]– [74], per Deane J.

⁴⁵ For example, Gummow J has expressed support for the notion that laws that deprive a person of the ‘the reality of proprietorship’ by affecting an acquisition of ‘the substance of a proprietary interest’ will trigger the requirement to provide just terms under s.51(xxxi) (*Newcrest Mining (WA) Ltd v Commonwealth* (1997) 190 CLR 513 at 595, see also *Smith v ANL Ltd* [2000] HCA 58 at [46] and [54], per Gaudron and Gummow JJ). Gleeson CJ has suggested the correct approach is to look at the ‘degree of impairment of the bundle of rights constituting the property in question’ (*Smith v ANL Ltd* [2000] HCA 58 at [22-23]). There are numerous decisions of the Mason and Brennan High Courts that are of relevance to this issue. However, the joint judgement of Dawson and Toohey JJ in *Mutual Pools and Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155 is especially noteworthy. Both judges consistently favoured a narrower interpretation of s.51(xxxi) than the likes of Kirby J and Callinan J. However, in their joint judgement in *Mutual Pools*, they recognised that if regulations prevented land from being used for a commercial purpose they could potentially affect an acquisition of property if the ‘regulation amounts to the use of property’ (for example, to achieve conservation objectives), even where there was no assumption of possession or transfer of title.

⁴⁶ *Minister for the Environment and Heritage v Greentree* (No.2) [2004] FCA 741.

considerable uncertainty about the operation of this section of the Constitution, there is a strong argument it could be triggered by the operation of certain environmental laws, particularly if the laws deprive farmers of the ability to use their land or water entitlements for any commercial purpose.

5.2 The states

The constitutional guarantee that property cannot be acquired other than on just terms does not apply to the states. State governments are, therefore, free to extinguish or acquire any property right, including a formal estate or proprietary right, from any person within their respective jurisdictions without providing compensation.⁴⁷ As McHugh J has stated:

... the owners of property in the various States ... have no such constitutional protection from acquisitions under State law, whether or not the relevant property arises under statute or the general law.⁴⁸

The fact that a state is not bound to pay compensation under the Constitution does not prevent it from doing so where it deems it appropriate. The states can achieve this either by creating a legal right to compensation or by making discretionary payments.

To date, where compensation has been paid to farmers for the impacts of native vegetation or land clearing laws, it has usually been done by way of discretionary payments. In Queensland, for example, the state government has promised to provide farmers with approximately \$150 million in compensation for the effects of recent changes to the *Vegetation Management Act 1999* (Qld) and *Land Act 1994* (Qld), which are designed to provide additional protection for 'remnant' and 'of concern' vegetation (Day 2004).⁴⁹ Similarly, in October 2003, the New South Wales Government announced plans to restructure its native vegetation laws and promised to provide farmers with \$406 million in compensation and adjustment assistance to lessen the impacts of the changes and assist in their implementation (Lewis 2003). In both cases, farmers have not been given a legal right to compensation. Rather, the compensation or 'restructuring assistance' payments will be made on a discretionary basis.

In a small number of instances however, landholders have been provided with a statutory right to compensation for restrictions on property rights that are imposed under biodiversity laws. For example, the *Flora and Fauna Guarantee Act 1988* (Vic) provides landholders (amongst others) with a right to compensation for 'financial loss suffered as a natural, direct and reasonable consequence' of the making of certain conservation orders under the Act.⁵⁰ However, as the Productivity Commission (2004, p. XXXII) has noted, this Act has rarely been used to restrict the use or development of land or water resources. As a result, the compensation provisions have hardly ever been triggered.

⁴⁷ *Durham Holdings Pty Ltd v New South Wales* [2001] HCA 7.

⁴⁸ *Commonwealth v WMC Resources Ltd* [1998] HCA 8 at [149].

⁴⁹ Hon Peter Beattie MP, *Queensland Tree Laws a Boost to Greenhouse Battle: Beattie*, Press Release, 15 March 2004 (available at: <http://statements.cabinet.qld.gov.au/portfolio-display/tmp/1085963553.html> (30 May 2004)).

⁵⁰ S.43.

State and territory environment and planning laws, such as the *Environmental Planning and Assessment Act 1979* (NSW) and the *Planning and Environment Act 1987* (Vic), often include provisions for the payment of compensation when certain property rights are restricted or extinguished (Smith 2002). However, the right to compensation that is available under these laws typically only applies when a planning permit or other approval is cancelled or amended.⁵¹ Further, the compensation that is provided is usually only intended to cover ‘sunk costs’ associated with the development that was initially authorised under the relevant planning permit or other approval. That is, the compensation is intended to reimburse the permit holder for the expenditure incurred in relation to the relevant development before the permit was suspended or amended (Smith 2002).

The current situation with respect to water entitlements is somewhat different in that a number of the water laws of various states and territories provide irrigators with a legal right to compensation if their entitlements are reduced. In most cases, the right to compensation arises if water entitlements are reduced during the life of a water management plan.⁵² However, as discussed above, the rights to compensation in New South Wales, Queensland, Victoria, and South Australia will be changed considerably under the National Water Initiative.

Given the existing constitutional framework concerning the acquisition of property, particularly the relative freedom of state governments to acquire property rights and the ability of territory governments to reduce statutory water entitlements without compensation, the question that arises is whether farmers should be provided with additional statutory rights to compensation (that is, additional to the rights provided in the Constitution) for restrictions on their property rights in land and water and, if so, what form should they take?

In order to answer these questions, it is necessary to consider two main issues, whether:

- the creation of additional rights to compensation will have a positive or negative impact on net social welfare (that is, will it improve allocative efficiency); and
- equity demands farmers be given additional rights to compensation.

The next section reviews the justifications for the use of regulations to alter agricultural practices so as to provide a basis upon which to examine the economic and equity arguments for and against the creation of additional statutory rights to compensation.

⁵¹ See, for example, *Environmental Planning and Assessment Act 1979* (NSW), s.96A and the *Planning and Environment Act 1987* (Vic), s.94.

⁵² For discussion, see Dyson (2002).

6. Justifying restrictions on property rights

This section briefly reviews the economic justifications for restricting property rights on environmental grounds. In particular, it looks at the main reasons for market failure in relation to the environment and the options that are available to governments to address these failures.

Free market economic theory suggests that socially optimal decisions will arise where resources are privately owned and there is a competitive and efficient market for the goods and services associated with the relevant resources. Where these conditions exist, the personally motivated decisions of the resource owners will result in the best outcomes for society.

In the case of natural resource management, the assumptions on which this theory rests seldom, if ever, exist. Three elements that are vital to the creation of efficient markets are typically missing from the pattern of ownership and use of natural resources: the ability to exclude others from using the resource; the ability to ensure the owners of the resource internalise all the costs and benefits associated with the use of the resource; and, accurate information on the condition of the resource and the effects of using it.

6.1 Open access, communal ownership and externalities

The problems associated with open access and communal ownership regimes in which there are no defined owners of the relevant resource, or where the resource is communally owned but there is no institutional framework for collective decision-making, have been discussed at length in a number of places, most famously in Garrett Hardin's seminal article 'The Tragedy of the Commons' (Hardin 1968).⁵³ The 'tragedy' describes a pattern of overuse of un-owned or communally owned resources that arise because of the inability to exclude people from using the resources (or to control their usage patterns) and the existence of negative externalities (being costs associated with an action that do not accrue to the person taking the action).

This argument is based on the premise that an economically rational individual will use a resource up until the point at which the marginal personal costs of using the resource equal the marginal personal benefits. Where the resource is not owned, or is communally owned, a significant proportion of the costs of the action (for example, the reduction or degradation of the resource) will be borne by the broader community or other communal owners. Therefore, without government intervention (either to regulate use or to privatise the relevant resource), the decisions of economically rational individuals will ultimately lead to overuse and degradation of the resource.

The difficulty that arises with respect to land and water resources is that it is virtually impossible to create effective private property rights over biodiversity and many of the processes and resources that are critical for the productivity of agricultural land and the health of the environment. That is, there are no effective property rights in,

⁵³ See also Challen (2000).

and no efficient markets for, biodiversity or the services supplied by ecosystems (what are sometimes called ‘ecosystem services’).⁵⁴

Take, for example, a farmer who has a freehold interest in a property. The farmer’s interest in the land is relatively secure and, subject to some minor qualifications, they are able to regulate who enters on to the land and who uses it. They will also own the native vegetation on the land and even have some rights in relation to wild animals found on the property (Smith 2002).⁵⁵ However, the farmer does not own the processes associated with the interaction of the biotic (living) and abiotic (non-living) components of the ecosystem that are critical to the productivity of their property and the health of the broader environment. These processes include such things as the interaction between native vegetation and the water table, insects that are necessary for pollination, wetlands that filter silt and other pollutants, predator-prey relationships that control pest numbers, and organisms that break down waste and recycle nutrients. While the farmer may own some of the resources that contribute to the functioning of these processes, the processes are effectively un-owned or communally owned and, without government intervention, there is no framework to regulate how they are used. In such a situation, the economically rational farmer will tend to overuse the natural resources they have access to because a significant proportion of the costs associated with the overuse will be passed on to the broader community. As a result, the cumulative impact of the economically rational decisions of the landholders in the relevant area is that the resources that are critical for the conservation of biodiversity and the provision of ecosystem services will be overused and degraded. Therefore, there is a need for the government to intervene to prevent or correct this market failure.⁵⁶

The same issues arise in the context of water rights. Market advocates have been quick to point to the fact that state and territory governments have effectively owned all water resources since the later part of the 19th century and beginning of the 20th century. Hence, state and territory governments must carry a significant proportion of the blame for the current condition of our water resources. In New South Wales, for example, the state government issued licences for the extraction of approximately 120 per cent of the available surface water (Melville and Broughton 2004; Fullerton 2003). This has led many commentators to support a shift from a state property regime to a private property regime, with an essential element being the creation of a statutory right to compensation if water entitlements are reduced (Young and McColl 2003; Melville and Broughton 2004).

Yet, as is the case with interests in land, the creation of more certain private property rights in water will not deliver an effective system of property rights, or an efficient market in the resources and processes that are essential to the health of the

⁵⁴ Ecosystem services include climate regulation, provision of shade and shelter, regulation of the water flows and groundwater levels, absorption of waste and pollution, nutrient recycling, and cultural and aesthetic values. For a discussion of ecosystem services, see Prime Minister’s Science, Engineering and Innovation Council (2002) and Daily (1997).

⁵⁵ For further discussion of common law and statutory rights concerning wild animals, see *Blades v Higgs* (1865) 11 ER 1474; *May v Burdett* (1846) 9 QB 101; and *Yanner v Eaton* (1999) 201 CLR 351. In relation to landholders’ interests in native vegetation, see *Re Ainslie*; *Swinbourne v Ainslie* (1885) 30 Ch D 485; *Corporate Affairs Commission v Austin Softwood Forest* [1978] 1 NSWLR 150.

⁵⁶ For further discussion of the ‘tragedy of open access’ in relation to Australian natural resource management issues, see Reeve (1999).

environment or freshwater dependent ecosystems. Therefore, there is a significant risk that the condition of Australia's water resources will continue to degrade. The existing evidence concerning the operation of water markets supports this conclusion (Cruse *et al.* 2003; Cruse *et al.* 2004). Even some of the more vocal advocates of creating more certain property rights in water have acknowledged that water trading will not necessarily result in better environmental outcomes. For example, a review of impacts of an inter-state water trading pilot program conducted by Young, Macdonald, Stringer and Bjornlund concluded that:

From a salinity perspective and in the long-run, inter-state trading can be expected to have a negative impact on river salinity (Young *et al.* 2000, p. 3).

6.2 Incomplete information

As noted above, another factor preventing the creation of efficient markets in natural resources is the lack of accurate and complete information. The role of biodiversity in the provision of ecosystem services and the linkages between certain resources and ecosystem services is poorly understood (Dawson 2004). This reduces the ability of the market to respond efficiently to environmental degradation. For example, due to a lack of information on the linkages between various aspects of the ecosystem, farmers are unable to predict accurately the consequences of land clearing. Hence, they may clear native vegetation to increase output only to find the result is greater salinity, erosion and decreased soil fertility, all of which ultimately leads to a decrease in productivity. The problems that arise as a result of the lack of complete information are exacerbated by the fact that many environmental outcomes are irreversible.

Similarly, the absence of information hinders the ability of the market to provide appropriate price signals to address poor management practices. For example, land values will not necessarily decline in response to the unsustainable use of a resource that is essential for the provision of an ecosystem service as the purchasers may not be able to measure the degradation or predict the outcome of the overuse. As a result, the lack of information can lead to overuse of resources as the relevant participants in the market are unable to predict the consequences of management decisions accurately.

6.3 Dealing with market failure: beneficiary pays or polluter pays?

As Aretino *et al.* (2001) discuss, policy makers are essentially faced with two broad choices for dealing with market failure concerning biodiversity and ecosystem services; the beneficiary pays principle and polluter (or impacter) pays principle.

The beneficiary pays principle suggests that anyone who obtains a benefit from a certain action should pay for the costs of undertaking it. This principle can be broken down into two parts: the user pays principle and beneficiary compensates or community pays principle. The user pays principle suggests that everybody who obtains a direct benefit from an action should pay some of the costs of the action, whereas the beneficiary compensates principle requires that anybody who obtains an indirect benefit from an action should contribute to the costs of an action.

In contrast, the polluter pays principle suggests that a person taking an action should be required to pay the full costs associated with the action, including the costs of environmental degradation.

For current purposes, it is sufficient to associate the call for compensation for restrictions on property rights with the beneficiary pays principle. That is, if the state wants to restrict the property rights of farmers, it must pay them for at least some of the benefits derived by the community. As noted above, in most cases, this has translated into a call for governments to pay farmers for the value of the public good environmental benefits associated with the action or regulation.

In theory, polluter pays approaches to environmental problems are inherently more efficient than beneficiary pays solutions. Take, for example, a farmer who wants to clear native vegetation to expand their output. Clearing the vegetation will have environmental costs, including biodiversity losses and soil degradation (for example, erosion and salinity). The polluter pays principle suggests that the most appropriate response is to force the farmer to pay for these costs and, assuming the farmer decides it is still profitable to go ahead with the clearing, for these costs to be passed on to consumers. If there is an efficient market for the relevant goods, the forces of supply and demand will ensure the outcome is efficient and that there is an equitable distribution of the costs associated with the action amongst those who benefit from it (Kennelly 1989; Aretino *et al.* 2001).

By contrast, the beneficiary pays approach suggests that if the community wants to avoid the costs associated with clearing the land, it must pay the farmer to refrain from doing so. This approach is justified on the basis that farmers have a right to use and develop their land as they see fit. Therefore, if the community does not want the farmer to clear the land, it must pay the farmer for the benefits it receives from the retention of the native vegetation. However, in paying the farmer to refrain from clearing the land, there is a transfer of resources from the broader community to the farmer and this decreases social welfare as those resources are no longer available for other purposes. It also lowers the per unit cost of the farmer's production, artificially lowering the price of the farmer's product and leading to an inefficient increase in the quantity of output demanded by consumers. The outcome is lower net welfare from the available resources.

The difficulty with this analysis is that the advantages associated with polluter pays approaches are dependent upon the state being able to determine accurately the externalities associated with a proposed action and to force producers to internalise those costs. If it is unable to do either of these, the outcome may be less efficient than alternative approaches as the costs producers are required to internalise may be more or less than the amount that accurately reflects society's preferences. In addition, polluter pays approaches often involve the use of regulations to prevent, or reduce, the frequency of certain activities. Regulations obstruct the operation of market forces. Hence, their efficiency is wholly dependent on the ability of the state to assess society's preferences and for these preferences to be reflected in the restrictions that are imposed on producers.

Although polluter pays policies are theoretically more efficient than beneficiary pays policies, governments often prefer beneficiary pays solutions to address environmental issues associated with natural resource industries (for example, farming, fishing and forestry) because they can have lower political costs. This can be explained by the nature of the relevant industries and property rights. As Challen observes:

Generally speaking, the political ramifications of institutional change are greater if the costs and/or benefits of change are incurred by small and/or concentrated groups in society that are able to mobilise resources for political lobbying, as opposed to large and/or dispersed groups. Consequently, it is relatively easy (low cost) for political decisions to be made that transfer property rights from a large dispersed group to a small concentrated group, but relatively difficult (high cost) to make the reverse change (Challen 2000, p. 178).

Although there are around 135,000 widely dispersed agricultural establishments in Australia, farmers have a well-established political infrastructure that allows them to mobilise political resources efficiently. Farmers also dominate a number of rural and regional electorates, which enables them to exert considerable influence over the outcome of federal and state elections. Consequently, governments are aware that if they adopt polluter pays policies to address environmental issues associated with agriculture, it may have a significant adverse affect on their chances of re-election. By contrast, beneficiary pays policies are likely to have less severe political consequences as a significant proportion of the financial costs associated with these policies will be borne by taxpayers rather than farmers.

In summary, the nature of natural resources and ecosystem services mean they will often be overused and degraded without effective government intervention. To resolve these issues, governments can either adopt polluter pays or beneficiary pays solutions. In theory, polluter pays approaches are more efficient because beneficiary pays policies must result in the payment of subsidies to producers which distorts the operation of the market and can exacerbate problems associated with the overuse of natural resources. However, in practice polluter pays policies will not necessarily be more efficient than beneficiary pays policies due to the lack of accurate and complete information and the nature of political decision-making processes. In recent times, governments in Australia have shown a tendency to use beneficiary pays approaches to resolve environmental issues associated with agriculture. This is likely to have more to do with politics than the efficiency of the relevant policies.

Having examined the justifications for restricting farmers' property rights in land and water resources and the means of doing so, the next section looks at whether the creation of additional legal rights to compensation for restrictions on farmers' property rights in land and water will have a positive or negative impact on net social welfare.

7. Compensation and social welfare

This section reviews the economic arguments for and against the creation of additional statutory rights to compensation for the impacts of environmental laws on farmers' property rights in land and water resources. In doing so, it seeks to answer the question of whether the creation of such additional rights will increase or decrease net social welfare.

7.1 Uncertainty

The main economic argument put forward in support of creating more secure property rights for farmers is that if compensation is not payable when property rights are restricted it creates uncertainty, which in turn distorts the allocation of resources, lowers investment and leads to less agricultural output (Carroll 2004; Anderson 2002; National Farmers Federation 2003c; Freebairn 2003; Moran 2003).

The risk that new environmental restrictions will be introduced or that existing environmental restrictions will be applied to prevent the use or development of a farmer's land or water resources, reduces the incentive for farmers to invest in their properties. If farmers are provided with additional legal rights to compensation, the regulatory risk remains. However, the potential financial impacts on farmers associated with the regulatory risk are eliminated or substantially reduced. Hence, so the argument proceeds, farmers will be more willing to invest in their properties (for example, by acquiring new infrastructure or purchasing additional water rights), which will result in a more efficient use of land and water resources.

The same chain of reasoning applies to financiers. Financiers are less likely to invest in an agricultural undertaking if there is a significant risk they will lose their money due to the operation of new or existing environmental laws. The uncertainty created by the regulatory environment, therefore, has repercussions for farmers in that it can be more difficult and more costly for them to obtain finance for agricultural developments. This can adversely affect agricultural productivity and, in certain circumstances, can lead to the degradation of land and water resources (Productivity Commission 2004).

Again, the creation of additional statutory rights to compensation lessens the risks to financiers as there is greater certainty that farmers will be able meet their financial commitments in the event of a change in the regulatory environment. Further, the statutory rights to compensation provide a degree of protection for the value of the farmer's land and water entitlements, which financiers often rely on as security for loans. As Stephen Carroll, a director of the Australian Bankers' Association has explained in the context of water entitlements:

Farming is about managing production risks associated with climate variability. Financiers back the ability of farmers to manage these types of risks. However, farmers and their financiers cannot manage uncertainty caused by the potential for ad hoc government intervention on perhaps the most critical risk to their farming activity: water ... The issue is about certainty of rights surrounding the use of water access entitlements and the holder's right to deal with the entitlement, and also the right of third parties with an interest in the entitlement to deal with it. Government intervention that significantly

impacts on the commerciality of a holder's right should be subject to compensation so as to protect the sustainability of existing commercial arrangements (Carroll 2004, p. 26).

There are several responses to these arguments.

Firstly, environmental laws need not generate excessive uncertainty. Whether environmental laws create uncertainty will be a product of several factors including how often they are changed, how the laws are developed, and their content or design. If:

- changes to environmental laws are infrequent and developed through a public and transparent process;
- the laws contain minimal ambiguity, transparent decision-making processes and strict timelines for approval decisions; and
- affected businesses are provided with an appropriate length of time to adjust to new requirements,

then there is no reason why environmental laws should create excessive uncertainty. Indeed, changes in environmental laws can reduce regulatory uncertainty by satisfying society's demands for higher environmental standards and clarifying areas of ambiguity.

It must be emphasised that the situation with respect to water entitlements is complicated by the need for flexibility in the size of the 'consumptive pool', the amount of water in a given water source that is made available for extractive uses. The main sources of uncertainty associated with water entitlements are the duration of water entitlements or licences and the degree to which the consumptive pool can be altered (assuming entitlements are defined as a proportion of the consumptive pool). Flexibility in the ability to renew licences and alter the size of the consumptive pool need not necessarily be associated with excessive uncertainty. Irrigators already have to deal with changes in the size of the consumptive pool caused by climate variations, although the financial impacts of drought are often offset by government drought assistance payments. If the rules concerning licence renewals and changes to the consumptive pool are clear, the scope for changes or non-renewals is confined within sensible limits and uncompensated changes that are designed to achieve environmental objectives are made relatively infrequently (for example, at ten year intervals), the negative financial impacts caused by the uncertainty associated with water entitlements can be kept low.

Secondly, with regard to existing native vegetation and biodiversity laws, the uncertainty they create will generally be associated with whether farmers can clear native vegetation. In most cases, farmers will be able to eliminate this uncertainty by simply applying to the relevant authorities for a permit or licence to clear the land.⁵⁷ As the Productivity Commission (2004) has noted, providing compensation for the

⁵⁷ Even if the relevant laws are changed after a farmer obtains a permit, they will usually still be able to clear the land in accordance with the terms of the permit under 'grandfathering' or 'existing use rights' provisions.

impacts of most existing native vegetation and biodiversity laws would merely result in a transfer of wealth from taxpayers to farmers. It will not increase agricultural productivity or output.

Thirdly, there is very little evidence to suggest that the uncertainty associated with native vegetation and biodiversity laws has had a significant adverse impact on productivity or investment in the agricultural sector as a whole. The data that are available on the economic impacts of native vegetation and biodiversity laws mostly focuses on relatively small geographical areas and is usually inaccurate due to a lack of relevant information on which to base economic estimates (Productivity Commission 2004; Slaughter 2003; Australian Bureau of Agricultural and Resource Economics and Bureau of Resource Sciences 2003; Sinden 2002; Moss 2002; Donaghy 1999; Scott and Sinden 1997). It also often fails to account adequately for the costs that would be incurred by farmers if the laws were not in operation. However, most relevantly, the vast majority of the data that is available on the financial impacts of native vegetation and biodiversity laws does not deal directly with the effects of any uncertainty that has been created by these laws. It merely concentrates on the opportunity costs to farmers and, in some instances associated communities, from the operation of the relevant laws. While direct economic losses from native vegetation and biodiversity laws may support arguments for compensation based on equity, they do not bolster the economic grounds for the creation of additional statutory rights to compensation based on uncertainty.

In addition, a large proportion of native vegetation in Australia's most productive agricultural areas has already been cleared, particularly in the south (National Land and Water Resources Audit 2001; National Land and Water Resources Audit 2002a). As a consequence, if native vegetation and biodiversity laws are appropriately designed (for example, they allow for clearing of woody weeds and low conservation value re-growth vegetation), they are most likely to affect fewer productive 'frontier' areas and small pockets of vegetation within productive areas. The fact that over half of the profit obtained from the agricultural industry is derived from less than one per cent of agricultural land gives an indication of the extent of the concentration of productive land (National Land and Water Resources Audit 2002b). Given this, and the ability of farmers to eliminate the uncertainty associated with most native vegetation and biodiversity laws by simply applying for a land clearing permit, it is difficult to accept that the uncertainty associated with these laws has, or will, severely curtail productivity in the agricultural sector as a whole.

The situation concerning water laws and water entitlements is different from that faced in the context of native vegetation and biodiversity laws. There is evidence that the uncertainty associated with past and present water management frameworks has had a notable impact on agricultural productivity (Bureau of Transport and Regional Economics 2003). As irrigated agriculture accounts for around 28 per cent of total agricultural output and over 50 per cent of profits derived from agriculture in Australia (National Land Water Resources Audit 2002b; National Land Water Resources Audit 2002c), there is the potential for regulatory uncertainty associated with water entitlements to affect significantly the economic performance of the sector as a whole. However, there is a considerable amount of evidence suggesting that moving to a water entitlement framework to provide greater certainty for irrigators is unlikely to result in large increases in permanent water trades or substantial increases

in agricultural investment or output (Crase *et al.* 2000; Crase *et al.* 2003; Crase *et al.* 2004). As Crase *et al.* observe:

Contingent data collected and analyzed by Crase *et al.* (2002; 2003) revealed that reducing uncertainty about water rights would invariably increase the demand for entitlements, thereby raising the bids for water, and that suppliers of permanent water were primarily motivated by price. However, extrapolating these data to the water market *per se* was likely to realize only a modest increase in the surplus generated by the water market. In essence, this is a function of the low price elasticity of supply for permanent water and the relatively modest increase in offers from potential buyers. ... [T]hese results cast some doubts over claims that further strengthening of water rights will give rise to significantly expanded production benefits in the basin (Crase *et al.* 2004, p. 21).

Consequently, while acknowledging there are limited data upon which to draw definitive conclusions, there is a strong argument that the costs of a more certain water entitlement framework, in the form of restrictions on the ability of the state to manage water in an adaptive manner to achieve economic, social and environmental objectives, will outweigh the economic benefits to extractive users.⁵⁸

Fourthly, all industries are subject to regulatory uncertainties concerning issues that are critical to their profitability and growth. Irrespective of the industry in which a business operates, it will constantly have to deal with changes in trade practices, taxation, workplace relations, occupational, health and safety, planning, building, insurance and other laws. In the majority of cases where the laws are appropriately designed and introduced in a suitable manner, the changes do not have dire economic consequences for the businesses concerned. While exceptions exist, these are likely to be associated with instances where the businesses that are affected are marginal and hence unable to absorb the additional costs associated with the regulatory changes, or society has deemed that the businesses should not be allowed to continue. There is no logical reason why the uncertainty associated with land clearing and water laws is any different from that caused by other laws. Similarly, leaving aside political preference, there is no reason why the agricultural sector should be treated any differently from any other sector in the Australian economy. Provided the laws are designed, introduced and administered appropriately, an efficient agricultural sector should be able to cope with new environmental standards that force farmers to internalise the full costs of production.

The history of environmental laws in Australia demonstrates this point. Since the early 1970s, industries that cause point-source pollution have been subjected to an ever growing suite of environmental regulations. Point source pollution from mining operations, for example, has been tightly regulated for a considerable length of time. Yet, these environmental restrictions have not crippled the mining industry. While some operators may have closed down and practices have changed, the industry continues to thrive.

In short, all industries face a degree of regulatory uncertainty. Whether this is excessive will depend upon a range of factors, including how often changes are made,

⁵⁸ For further discussion, see Crase *et al.* (2003); Crase *et al.* (2004), and Pagan and Crase (2004).

how the laws are developed, and their content or design. The argument that additional statutory rights to compensation for the impacts of native vegetation and biodiversity laws will lower uncertainty and increase agricultural productivity appears to be without merit. It is likely to result merely in a transfer of wealth from taxpayers to farmers. The argument in favour of creating additional statutory rights to compensation for the impacts of changes in water allocations has considerably more worth. However, there is a lack of compelling evidence to suggest the creation of these rights will lead to significant increases in water trades, investment or agricultural output. As a result, there are strong grounds for asserting that governments should be cautious when considering whether to grant additional rights to compensation for reductions in water allocations so as to ensure they leave themselves with sufficient flexibility to respond appropriately to changes in economic, social and environmental conditions.

7.2 Diversion of public resources

While providing farmers with additional legal rights to compensation may reduce uncertainty and have some positive economic impacts, it will also result in a shift in government resources to the agricultural sector, with a commensurate reduction in the provision of other government services. As Martin and Verbeek explain:

Compensation for acts of the state comes from the pool of taxation revenues. Any claim on this pool competes against all others, including other equity claims such as health, education, or pensions. It also competes against claims like support for economic growth (including infrastructures and subsidies for resource use) and national interests like defence (Martin and Verbeek 2002, p. 6).

Therefore, if the demands of farmer lobby groups are satisfied and the National Water Initiative is implemented, most programs that seek to achieve public good environmental benefits by restricting the property rights of farmers will result in a reduction in other government services.

7.3 Inter-temporal transaction costs

Due to our relative ignorance of how ecosystems function, the fact that they do not have a tendency towards a state of equilibrium and the projections of climate change, it is inevitable that unforeseen environmental problems will arise in the future. It is also inevitable that society's desire for the conservation of various aspects of the environment will fluctuate through time. Therefore, to achieve the most efficient allocation of resources and to maximise social welfare, it is essential that governments have the capacity to respond efficiently and effectively to environmental, social and economic changes.

However, if governments adopt a beneficiary pays approach to environmental issues by providing farmers with additional rights to compensation for restrictions on property rights, the potential for effective government action could be severely reduced. If an unforeseen environmental problem arises, or society demands greater environmental protection, in many instances governments will have to pay farmers significant amounts of money if they want to respond to these challenges. This will

increase the financial costs of responding, which in turn will diminish the ability and willingness of governments to act.⁵⁹

This argument has been put forward by a number of commentators (Challen 2000; Crase *et al.* 2003; Pagan and Crase 2004; Environmental Defender's Office (NSW) Ltd 2004; Reeve 1999). Challen, for example, states:

Some institutional reforms in the present, particularly those that strengthen private property rights, may reduce the flexibility of governments to respond to new knowledge and changing parameters. There may be value in maintaining institutional flexibility, albeit possibly at the expense of present benefits from resource use (Challen 2000, p. 8).

An additional problem associated with the creation of a right to compensation is that the political influence of farmers makes it unlikely that this right will be able to be repealed in the future, irrespective of whether it is later found to be having an adverse impact on net social welfare. Challen (2000, p.178) describes this as the 'notion of irreversibility of institutional change'. The apparent irreversibility arises because of the likelihood that farmers would fiercely oppose any attempt to take away the right together with their ability to influence the electoral fortunes of federal and state governments.

While the provision of additional rights to compensation could increase agricultural output (primarily by improving the allocation of resources and encouraging investment in agricultural infrastructure), it will also create barriers that will hinder the ability of governments to respond to future environmental, social and economic issues. The long-term costs associated with the decision-making barriers created by the requirement to pay compensation may cancel out the economic benefits to farmers. This is the main flaw in the compensation framework proposed under the National Water Initiative, a conclusion based on three main arguments.

Firstly, the National Water Initiative does not give sufficient flexibility to the relevant governments to make uncompensated reductions in consumptive water allocations to achieve new environmental and other public benefit objectives that arise as a result of changes in social values or the recognition of existing social values. To some degree, the magnitude of this problem will depend on what environmental and other public benefit objectives are specified in water management plans prior to the commencement of the rights to compensation (including whether these objectives adequately address over-allocation and overuse issues). Not surprisingly, farm lobby groups and irrigators have fiercely opposed recent attempts to reduce consumptive water allocations under programs such as the Living Murray Initiative (Victorian

⁵⁹ The barriers to future changes, including the costs of compensation, are what economists refer to as inter-temporal transaction costs or path dependence. Transaction costs refer to the broad ranges of costs associated with any system of making allocation decisions. Most commonly, the term is used to refer to the costs associated with the operation of a market transaction. However, it can encompass the broader costs associated with making any allocative decision under market and non-market structures, such as the costs of research, determining who could be affected by the decision, negotiation, creating and maintaining institutions, preparing legislation and contracts, advertising the proposed decision, the costs of lobbying, political repercussions for decision-makers, compensation payments, and the costs associated with monitoring and policing compliance with the decision. For discussion, see Challen (2000).

Farmers Federation 2002; Paxinos 2004). Given the window provided under the National Water Initiative for uncompensated reductions to address over-allocated and overused systems, there is little doubt that farm lobby groups will maintain their opposition to proposals to make substantial reductions in allocations in the knowledge that by postponing measures to address unsustainable water use patterns they will be able to shift a significant proportion of the financial risks associated with these changes from farmers to taxpayers (Murray Irrigation Ltd 2003).⁶⁰ Irrespective of what steps are taken to address water allocation and environmental issues during the period before the rights to compensation commence, it is nevertheless inevitable that social preferences will change in the future. However, under the National Water Initiative's risk allocation framework, taxpayers will be forced to bear all of the costs associated with reducing water allocations for these purposes. This financial burden will reduce the willingness of governments to respond to social pressures and impede the achievement of the most efficient allocation of water resources.

Secondly, the National Water Initiative does not provide sufficient scope for uncompensated reductions to water allocations that arise 'as a result of bona fide improvements in the knowledge of water systems' capacity to sustain particular extraction levels'. Three facts support this proposition.

- It is doubtful whether sufficient steps will be taken to address the over-allocation and overuse problems that exist in many catchments prior to the rights to compensation coming into operation. As noted above, many farmers and farm lobby groups have clearly expressed their opposition to large reductions being made to consumptive water allocations, particularly where the affected farmers and communities will not be compensated (Paxinos 2004; Murray Irrigation Ltd 2003; Victorian Farmers Federation 2002; Commonwealth House of Representative Standing Committee on Agriculture, Fisheries and Forestry 2004). Given the political influence of farmers and the costs of recovering water for environmental purposes, governments are unlikely to reduce farmers' water allocations significantly or invest sufficient amounts of money in other methods of increasing environmental flows in the period before the rights to compensation commence. The fact that COAG has committed only \$500 million to increase environmental flows in the River Murray by 500 gigalitres when the best available science indicates that an additional 1,500 gigalitres is likely to give the river only a moderate chance of returning to a healthy state, provides an indication of the reluctance of governments to respond decisively to reduce water allocations in order to conserve environmental assets (Scientific Reference Panel 2003). If appropriate environmental allocations are not specified in water management plans as part of the process of addressing known over-allocation or overuse problems, politicians will be forced to choose between ignoring the most obvious examples of the ongoing deterioration of Australia's water resources and investing large quantities of money to recover water for the environment. The recovery of the water could obviously be achieved either by acquiring rights from farmers (either voluntarily or compulsorily) or by investing in improvements in water infrastructure. However, irrespective of the method that is chosen, there will be a significant financial cost to add to other

⁶⁰ See, for example, National Farmers Federation, *NFF Wants Secure Water Access Entitlements as Part of First Step Living Murray Proposal*, Press Release, 12 November 2003.

transaction costs (particularly the political costs) associated with any attempt to address over-allocation and overuse problems in the future. This will reduce the likelihood that any government will make significant reductions in water allocations. Greater scope for making uncompensated reductions in allocations would lessen the financial impediments associated with reducing allocations, and thereby increase the likelihood that over-allocation and overuse problems will be adequately addressed in the future.

- Natural systems are constantly changing, as is our knowledge of these systems and their capacity to withstand the impacts of human activities. This makes it inevitable that there will have to be changes in water allocations to achieve environmental and other public benefit objectives. Some may argue there is sufficient scope in the National Water Initiative framework to cope with natural variability. However, global warming creates considerable uncertainty about the extent to which flows may vary in the future and casts doubt on our ability to rely on historical data in making decisions about future water availability. The existing evidence concerning the possible impacts of global warming on flows in major catchments suggests there is a significant risk that water allocations for consumptive uses will have to be reduced considerably over the next 30 to 50 years if important environmental values are to be conserved (Australian Greenhouse Office 2003). There is evidence, for example, that flows in the Murray Darling Basin could drop by 25 per cent by 2050, and by 50 per cent by 2100 (Beare and Heaney 2002). Even if we assume that all relevant environmental and heritage values are incorporated into water management plans prior to the commencement of the rights to compensation, in the case that current climate and flow impact predictions are accurate, the state will be required to expend large amounts of money to recover flows for the environment to protect and conserve these values. Again, this financial burden, when combined with the political and other transaction costs associated with reducing water allocations, is likely to act as a significant barrier to responsive management in many areas.⁶¹
- As water becomes scarcer, it is likely that irrigators will use it more efficiently, thereby diminishing the amount of water that is returned to rivers, wetlands and aquifers for use by other people and the environment (Young and McColl 2003). There are also likely to be changes in land use practices (for example, an increase in farm forestry) that have profound effects on the hydrology of certain catchments. Although the National Water Initiative does seek to address these issues to some extent, there is a significant risk that changes in land use practices and water efficiency will erode the allocations that are available for environmental purposes.⁶² If this occurs, governments will have to reduce consumptive water allocations or recover water by other means if they want to achieve environmental and other public benefit

⁶¹ Western Australia's decision to refuse to enter the National Water Initiative appears particularly sensible when regard is had to the evidence concerning the vulnerability of the state to the impacts of global warming on water availability (Australian Greenhouse Office 2003).

⁶² See, for example, clause 35, which states that environmental allocations must 'be given statutory recognition and have at least the same degree of security as water access entitlements for consumptive use and be fully accounted for'. See also clauses 55-57 in relation to changes in land use practices and interception.

objectives. Once more, the requirement to pay compensation where consumptive water allocations are reduced could impede proper management practices.

Finally, the compensation framework proposed under the National Water Initiative hinges on the concept of sustainability and the ‘environmentally sustainable levels of extraction’. However, what constitutes the ‘sustainable levels of extraction’ for a particular water system is highly subjective and cannot be resolved solely by reference to science. Even if the notion of sustainability is linked to the achievement of specified environmental objectives, given the characteristics of natural systems and the subjectivity associated with evaluating their health, it will remain difficult to determine conclusively whether extraction levels are sustainable. The uncertainty associated with the concept of ‘sustainable levels of extraction’ may lessen the willingness of governments to make uncompensated reductions in water allocations because of the potential for their decisions to be challenged by farmers, farm lobby groups and opposition political parties. Hence, if governments wish to address sustainability issues, they may be forced to shoulder all of the financial costs associated with reducing water allocations. It would be more appropriate if the compensation framework in the National Water Initiative provided governments with the flexibility to make uncompensated reductions in water allocations for any purpose, provided the allocations could be reduced by only a certain percentage (for example, ten per cent) over a specified period.

The counter argument is that the creation of additional statutory rights to compensation may actually improve the willingness of governments to act by lowering the political costs and certain other transaction costs (for example consultation costs) that are associated with the introduction of new environmental restrictions. Therefore, while there will be a requirement to make direct payments to the affected farmers, savings in other areas (particularly in the political domain) may lead to more responsive decision-making and improved outcomes. However, it is by no means clear that these transaction costs will be substantially reduced, let alone eliminated. The experiences encountered with other natural resource management issues (particularly fisheries and forestry) suggest that transaction costs will continue to be significant, notwithstanding the fact that the affected property owners are aware they will be compensated for the impacts of the relevant restrictions.⁶³

There is, therefore, a significant risk that the creation of more secure property rights in land and water will have an adverse impact on net social welfare as it will restrict the ability of governments to respond to future environmental, social and economic issues while not substantially reducing the political costs associated with changes in property rights.

7.4 Legal rights to compensation vs. discretionary compensation

Farm lobby groups argue that creating a legal right to compensation will provide greater certainty and result in a more efficient allocation of resources. However, if farmers have additional legal rights to compensation for restrictions on property

⁶³ This may be due to the fact that farmers, like fishers and forestry workers, are often wedded to the lifestyle associated with their chosen career and that money is not necessarily an effective substitute for the lifestyle changes that can follow restrictions in property rights.

rights, there is a significant risk it will lead to complex and costly litigation over when, and how much, compensation is payable (Environmental Defender's Office (NSW) Ltd 2004). Substantial resources could be wasted in court proceedings that would be better spent on improving environmental outcomes and providing other government services. Litigation could also delay the provision of financial assistance to farmers who have suffered acute losses as a result of environmental restrictions and who are deserving of government support.

Whether the risk allocation framework proposed under the National Water Initiative creates excessive litigation will depend on how the principles in the agreement are incorporated into legislation. If the intention is to use a distinction between reductions arising from changes in government policy and reductions arising from changes in the knowledge of a water system's capacity to sustain particular extraction levels, the risks of litigation are likely to be substantial.

A further problem with creating additional legal rights to compensation is the likelihood that payments will not be made in a manner that reflects an appropriate balance between the user pays and beneficiary compensates principles. Striking an appropriate balance between these two components of the beneficiary pays principle requires flexibility so as to enable the decision-maker to take into account the range of factors that determine who benefits from a particular regulatory measure.

Unfortunately, legal processes are often ill-suited to this task as they generally require more rigid decision-making frameworks that reduce the scope of the decision-maker to balance competing interests. Courts may also lack the necessary range of skills to find an appropriate balance between the user pays and beneficiary compensates principles. Therefore, there is a significant risk that creating additional legal rights to compensation will result in an economically inefficient distribution of the costs and benefits associated with regulatory measures.

An additional problem associated with the beneficiary pays model, particularly where it is based on a legal right to compensation, is that it can provide incentives to threaten to damage the environment. For example, if compensation is payable when a farmer's application to clear native vegetation is refused, farmers may submit bogus applications so as to obtain payments. Resources will then be wasted both in making payments to unscrupulous farmers and in trying to detect bogus applications.

7.5 Additional subsidies

As discussed, an unavoidable side-effect of beneficiary pays policies is that they result in the payment of subsidies which distort the distribution of resources. This is due to the fact that the payments to the affected property owners enable them to undercut other producers. However, additional subsidies can arise due to the practical difficulties associated with separating the private and public benefits that flow from a particular activity.

The subsidy provided to farmers by beneficiary pays policies will be increased if they are not required to pay for the benefits they derive from the relevant regulatory action. For example, if a farmer is prevented from clearing a patch of riparian vegetation and that patch of vegetation will provide the farmer with benefits such as cleaner water and reduced erosion, any compensation payments should be reduced to account for these localised and private benefits. If they are not, the beneficiary pays structure will

lack the user pays component, so it becomes exclusively a beneficiary compensates model.

As discussed, the risk of compensation payments becoming subsidies is magnified where the payments are based on a legal right to compensation, as courts are unlikely to have the necessary flexibility to reach an appropriate balance between the user pays and beneficiary compensates principles.

The compensation framework proposed under the National Water Initiative fails to deal adequately with the need to balance the user pays and beneficiary compensates components of the beneficiary pays principle. The relevant state and territory governments will be forced to pay the costs associated with reductions in water entitlements arising from changes in policy. Furthermore, after 2014, these governments and the Commonwealth will also be forced to pay 97 per cent of the costs associated with reductions in water entitlements that are prompted by 'bona fide improvements in the knowledge of water systems' capacity to sustain particular extraction levels'.⁶⁴ In both cases, farmers are likely to receive private benefits as a result of the increase in environmental flows in the form of improved ecosystem services. Yet, under the proposed risk allocation framework, farmers are only likely to bear a fraction of the costs associated with these changes. In this regard, the National Water Initiative does mention the possibility of using water pricing as a means of accounting for positive and negative externalities associated with water use.⁶⁵ However, politics and the marginal nature of many agricultural businesses makes it highly unlikely that governments will increase water prices as a means of recovering some of the costs of reducing water allocations. Hence, it is likely farmers will receive a substantial subsidy from the broader community in these circumstances.

An additional problem peculiar to water issues is that the creation of a legal right to compensation can result in the payment of outright subsidies in catchments that contain so-called 'sleeper licences' (being licences that have been issued but not used). In these circumstances, the state can effectively be 'buying-back' water that does not exist (if water resources are substantially over-allocated in the relevant catchments) or entitlements that farmers have not relied upon to their detriment (which is one of the main justifications for compensation payments, particularly in instances where the resource user does not own the relevant resource). Whether this issue becomes a significant problem will depend largely on how effective state and territory governments are in reducing water entitlements and setting appropriate environmental objectives before the statutory rights to compensation commence (Young and McColl 2003).

The Productivity Commission's proposal concerning the acquisition of public good environmental benefits also seems to suffer from this problem. The Commission appears to suggest public good environmental benefits should be those that are over and above the environmental objectives that are specified by regional management committees as being necessary for sustainable resource use. For example, it states:

The Commission is proposing that regional bodies be given greater autonomy to devise integrated solutions to environmental problems, including primary

⁶⁴ Clause 49.

⁶⁵ Clauses 65 and 73.

responsibility for determining what, if any, intervention is required to achieve those solutions as efficiently as possible and how the costs should be distributed amongst landholders and others.

... Over and above designated landholder responsibilities, the public-good conservation desired by the wider community (for example, to meet biodiversity, threatened species and greenhouse objectives), should be purchased from individual or groups of landholders.

... If a region adopted a native vegetation target of, say, 20 per cent, a system of tradable credits could spread the burden amongst landholders in the region, reward the contribution of those who have retained native vegetation, while allowing higher-valued agriculture to proceed.

If society demanded additional native vegetation conservation – say minimum levels of 30 per cent native vegetation to promote biodiversity objectives – then payments would be made to landholders for the incremental costs of achieving these higher targets (Productivity Commission 2004, pp. 234-237).

This proposal is unlikely to result in an accurate division of public and private benefits between farmers and taxpayers. Most obviously, as the Productivity Commission suggests that regional management committees should be ‘representative of the population of the region’ (2004, p. 235), there is a significant risk farmers on these committees will engage in strategic rent seeking behaviour so as to transfer the costs of achieving environmental outcomes from farmers to the government. Therefore, the proposal is likely to result in additional subsidies being provided to farmers as the compensation framework is unlikely to reflect accurately an appropriate balance between the user pays and beneficiary compensates components of the beneficiary pays principle.

7.6 Double payment

The argument in support of the beneficiary pays principle is essentially that private property owners should not be forced to shoulder all of the costs associated with the provision of public good environment benefits. However, if the private property owners are receiving subsidies from the government, society has already effectively paid for these benefits. Therefore, if compensation payments for restrictions on property rights are not reduced to account for subsidies the relevant farmers have received from the government, they will constitute a double payment. As Aretino *et al.* state when explaining the basic elements of the beneficiary pays principle:

Payments to individuals to cover the costs of inputs should be net of other payments or subsidies from government that reduce the cost of inputs to avoid ‘double payment’ (Aretino *et al.* 2001, p. 33).

Details of the subsidies that are provided to the agricultural sector are outlined in Section 8 below. However, it is worth noting here that the agricultural industry is one of the most highly subsidised industries in Australia (Productivity Commission 2002). Therefore, there is a substantial risk that any compensation payments to farmers for restrictions on property rights will involve double payments.

7.7 Reduced incentives to improve practices and the domino effect

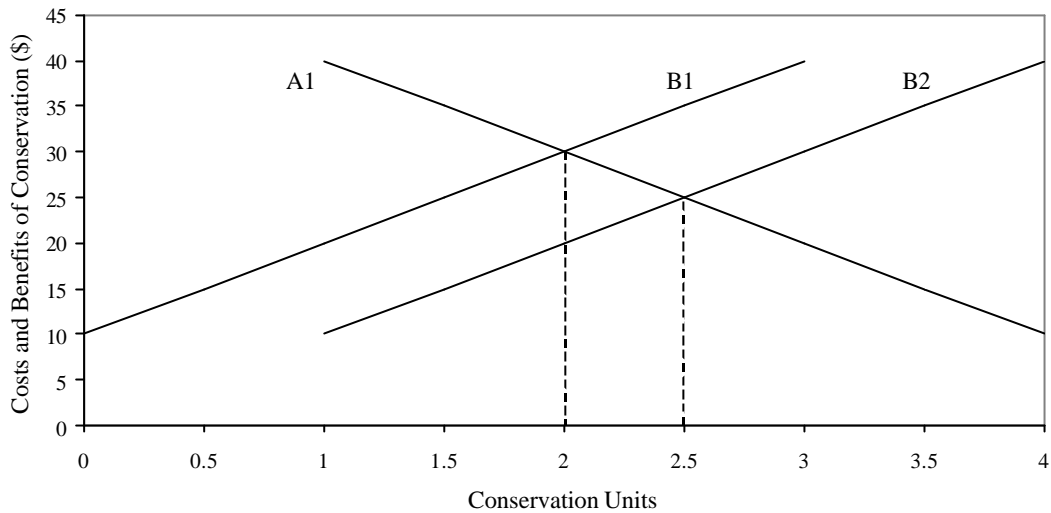
The payment of compensation to farmers for regulatory restrictions on their property rights can reduce the incentive for them to adopt sustainable natural resource management practices. Take the case of a farmer who recognises their irrigation practices are damaging the environment, primarily because they are extracting too much water from the local river at a time of year when the ecosystem needs higher flows. Why would the farmer voluntarily reduce their water use if they can get paid by the government to do so? There is a disincentive to reduce diversions voluntarily, 'because their adoption ... would result in a reduction in subsidy payments to them in the future' (Aretino *et al.* 2001, p.21). The creation of additional rights to compensation can also reinforce perceptions that property owners have a right to manage 'their' resources in an unsustainable manner.

The creation of additional legal rights to compensation for restrictions on farmers' property rights could also result in similar claims from other property holders (Environmental Defender's Office (NSW) Ltd 2004). As there is no valid reason for providing farmers with special treatment, other property holders would be justified in demanding a right to compensation if their property rights are abrogated for public purposes. Residential property owners, for example, could claim a right to compensation for the restrictions imposed under urban planning and environmental laws. Similarly, fishers could claim a right to compensation for reductions in catch limits or the establishment of marine protected areas. The extension of a right to compensation to other interests in property would severely restrict the ability of governments to govern in the best interests of the community.

7.8 Excessive conservation

Some commentators argue that if governments are not required to pay for the benefits of conservation, more conservation may be demanded than is socially optimal (Kennelly 1989; Tilton 1995; Productivity Commission 2004). Hence, by requiring compensation to be paid for restrictions on property rights, they argue that a more efficient balance between extractive use and conservation will be reached.

The logic behind this argument is illustrated in Figure 1 below.

Figure 1 Compensation and excessive conservation

The horizontal-axis provides the level of conservation expressed in conservation units, while the vertical-axis measures the costs and benefits of the conservation units in dollars.

The A1 line represents the level of public demand for conservation units when the benefits associated with conservation are fully known. The B1 line shows the estimated costs associated with each unit of conservation when there is complete information and this information is internalised in society's decisions regarding conservation. The socially optimal level of conservation in this case is two conservation units.

The argument in support of compensation assumes that a large proportion of society is prone to underestimating the costs associated with conservation. Presumably, this is because the financial interests of a significant proportion of the population (mainly urban residents) are not directly affected by decisions to increase conservation. As a result, or so the proponents of compensation assert, society's cost curve will tend to be further to the right than it should be. Here, this is represented by the B2 line. In this scenario, a cost-benefit analysis would suggest society's preferred level of conservation is 2.5 conservation units (that is, 0.5 units above what is, in reality, the socially optimal outcome).

Given this, the proponents of compensation claim that if governments are required to compensate property holders whose rights are restricted for environmental purposes, it will be easier for all members of society to assess the costs associated with conservation more accurately. The cost curve will then shift to the left and the outcome will be more efficient.

There are a number of responses to this argument. Firstly, it does not necessarily support the need for additional legal rights to compensation. It merely suggests that the government should provide some compensation for restrictions on property rights. For the reasons discussed above, enshrining additional rights to compensation in legislation can easily result in inefficient outcomes. If compensation is justifiable on equity and efficiency grounds, it may be more efficient for the payments to be made on a discretionary basis.

Secondly, this argument is based on four main assumptions, that:

- the current generation is able to assess the benefits associated with each level of conservation adequately;
- unless governments are required to compensate property holders whose property rights are restricted or extinguished for environmental purposes, society will underestimate the costs of conservation;
- society's demand for conservation will respond appropriately to changes in the amount of money governments are required to pay to achieve conservation outcomes; and
- government decision-making processes regarding conservation are responsive to social preferences.

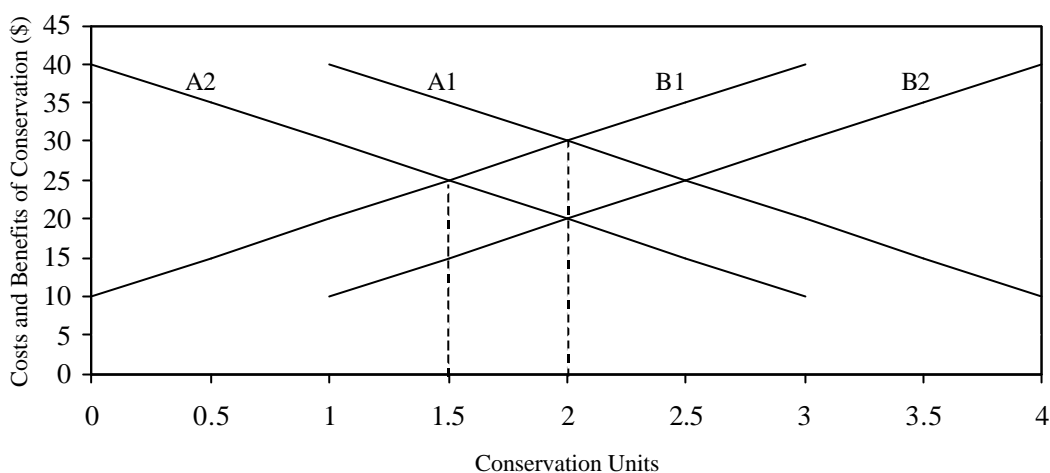
The degree to which these assumptions accurately reflect reality varies considerably.

Our knowledge of the natural world is extremely limited. Very little is known about the interaction between various components of the environment, the role of biodiversity in the provision of ecosystem services or the long-term environmental impacts of our use and development of natural resources (Australian State of the Environment Committee 2001; National Land and Water Resources Audit 2002a; Prime Minister's Science, Engineering and Innovation Council 2002; Dawson 2004). Even within scientific circles, there are fierce disagreements about the degree to which governments should be seeking to conserve certain elements of the environment (Dawson 2004). Within the broader community, it is likely there are misunderstandings about the complexity of the issues and the importance of conservation. The absence of information about the environment and low levels of public awareness make it highly unlikely that the current generation will be able to assess accurately what level of conservation will maximise the long-term welfare of the community.

Similarly, there is no evidence to support the assertion that society is prone to underestimating the costs associated with conservation. If anything, it is more likely that the costs of conservation will be overestimated by most Australians. This is a product of Australia's economic culture and the well-known tendency for many urban residents to empathise with people in natural resource industries, particularly farmers. This was illustrated in 2002, when a number of corporations, including Channel 9, Visy, 2GB and News Limited, established the Farmhand Appeal which went on to raise approximately \$25 million to assist farmers to cope with the effects of drought.⁶⁶ However, the reality is that there is insufficient evidence upon which to make assumptions either way.

The limitations on the public's ability to assess accurately the costs and benefits associated with conservation, significantly weakens the arguments in support of creating a statutory right to compensation. This is illustrated in Figure 2 below.

⁶⁶ For further details, see <http://www.farmhand.org.au/> (10 August 2004).

Figure 2 Effects of incomplete information on arguments for compensation

Again, the A1 and B1 lines represent the estimated costs and benefits associated with conservation when there is complete information and this information is incorporated into society's preferences. The socially optimal level of conservation in this case is two conservation units.

The A2 line represents the level of public demand for conservation units when there is incomplete information on the benefits associated with conservation and these benefits are undervalued. If we assume society also underestimates the costs of conservation so the cost curve becomes B2, a cost-benefit analysis would suggest two conservation units is the most desirable level of conservation (that is, the same as what is, in reality, the socially optimal outcome). However, if governments then decide to provide a statutory right to compensation, assuming social preferences respond in the desired manner to changes in prospective government expenditure, the cost curve would shift to the left, returning to B1. Under this scenario, a cost-benefit analysis would suggest the socially optimal level of conservation is approximately 1.5 conservation units, 0.5 conservation units below the most efficient outcome. This analysis suggests creating a statutory right to compensation could exacerbate the problems caused by the lack of accurate information or merely result in the transfer of wealth from taxpayers to farmers, without necessarily improving the correlation between social preferences and socially optimal outcomes.

The assumption that society's demand for conservation will respond appropriately to changes in the amount of money governments are required to pay to achieve conservation outcomes is also dubious. Obviously, if governments are forced to pay farmers enormous amounts of money to achieve conservation outcomes, there is little doubt it would influence social preferences regarding conservation. However, very little data are available about the degree to which social preferences towards conservation fluctuate in response to changes in government outlays. It may be the case that there are delays in the responsiveness of social preferences, or that the requirement to pay compensation causes people to overestimate the costs of conservation. In both instances, other things being equal, the outcomes could be less, not more, efficient.

Similarly, the degree to which government decision-making processes regarding conservation are responsive to social preferences is debatable. The argument that

government decision-making processes are highly responsive to social preferences is based on the assumption that governments employ a rational-action model of decision making in which objectives are determined, options are identified, and the choice of outcome is determined by weighing the costs and benefits of each of the available options (Doyle and Kellow 1995). However, government decision-making processes are far more complex than this model envisages and are often highly influenced by short-term political objectives. As a result, governments often make decisions that do not reflect society's preferences, but rather are designed to satisfy the demands of a sub-section of the community. Consequently, even if society tends to underestimate the costs of conservation and social preferences are responsive to prospective government outlays, increasing the costs associated with conservation by granting farmers a statutory right to compensation will not necessarily result in more socially optimal outcomes.

A third weakness in the argument that a requirement to pay compensation will improve social welfare is that it makes no attempt to account for the existing barriers and costs that restrain governments from adopting policies to protect the environment. Governments that restrict property rights for environmental purposes are often forced to endure considerable political costs, particularly in the electorates in which the property holders are located. Further, the abrogation of property rights for environmental purposes will often have economic costs both for the affected property holders and the broader community. These economic and political costs lessen the willingness of governments to act to address many environmental issues, even where the available evidence suggests the failure to do so could have a significant adverse impact on social utility. Transferring economic costs from landholders to governments may simply exacerbate this problem, rather than improving welfare outcomes.

Finally, the argument that compensation is necessary to ensure optimal conservation outcomes is based on the premise that farmers have a right to impose the costs of their activities on other people and the broader community. It is the equivalent of saying that smokers have a right to force others to suffer from passive smoking, or that factories have a right to emit toxic substances into waterways or the environment. To accept the argument in favour of the beneficiary pays principle in relation to farmers' property rights is to accept that environmental costs associated with agriculture are a 'lower order cost' and that taxpayers (rather than consumers and farmers) should shoulder these costs as an inescapable part of the benefit of having an agricultural industry.

7.9 Summary of impacts on net social welfare

There is a significant risk that the creation of additional statutory rights to compensation for restrictions in farmers' property rights will have a negative impact on net social welfare.

In relation to interests in land, there appear to be no compelling economic reasons that would justify the creation of additional rights to compensation for the impacts of native vegetation and biodiversity laws. The creation of additional rights would impede the ability of governments to respond to environmental threats and changes in social preferences, divert scarce public resources from other valuable government programs, increase the risk of wasteful litigation, reduce incentives to adopt

sustainable natural resource management practices, and increase subsidies to the agricultural sector. Yet it is unlikely to lead to a significant improvement in agricultural productivity. Hence, the risks associated with the creation of these rights appear to significantly outweigh any potential benefits.

In contrast, there are valid economic reasons for creating additional rights to compensation for reductions in water entitlements. This is due to the fact that reducing the uncertainty associated with water entitlements may improve the allocation of agricultural resources, encourage greater investment and increase agricultural output. However, there is a considerable amount of evidence suggesting that the economic benefits associated with more secure water rights are likely to be relatively modest. Therefore, whether the impacts on social welfare of creating additional rights to compensation for reductions in water entitlements are positive or negative will largely depend on the nature of the rights that are created. If the rights are too broad, they are likely to have an adverse impact on social welfare for the reasons discussed in the context of farmers' interests in land.

The rights to compensation proposed under the National Water Initiative are excessive in that they do not provide the relevant governments with sufficient flexibility to respond to environmental issues and changes in social values. The National Water Initiative risk allocation framework is also likely to lead to additional subsidies being provided to the agricultural sector and could result in wasteful litigation.

As discussed above, the question of whether farmers should be provided with additional statutory rights to compensation for restrictions on their property rights in land and water resources cannot be resolved solely by reference to the net impact on social welfare. Regard must also be had to the question of whether equity supports the creation of these rights. The following section seeks to determine whether it is equitable for farmers to be provided with additional statutory rights to compensation for restrictions on their property rights in land and water resources.

8. Compensation and equity

8.1 The argument in favour of compensation

It is unthinkable that in a democratic society, particularly in normal and peaceful times that those who elect a government would regard with equanimity the expropriation of their or other private property without proper compensation. What the public enjoys should be at the public, and not a private expense.⁶⁷

The above extract from Callinan J's judgement in *Smith v ANL Ltd*⁶⁸ captures the essence of the argument of the farm lobby groups that equity demands that farmers be provided with compensation where their property rights are restricted in order to achieve public good environmental outcomes. The argument is simply that to take or deprive a person of the benefits of property that they own or possess without compensation is fundamentally unjust. Kirby J expressed similar sentiments in *Newcrest Mining (WA) Ltd v Commonwealth*,⁶⁹ where he described the right to due process and compensation for the deprivation of property rights as a 'fundamental' and 'universal' right.⁷⁰

Although this rationale is appealing in the abstract, it fails to recognise the essential need for governments to regulate the use of property to achieve socially desirable outcomes. If compensation must be paid to all property holders whose rights are restricted or reduced for public purposes, governments would be incapable of performing many of the functions for which they exist. However, the fact that compensation should not be payable in all circumstances does not mean it should never be paid, and one of the key determinants of whether it should be paid is equity.

The Macquarie Dictionary defines 'equity' as:

...the quality of being fair or impartial...that which is fair and just.

This section analyses whether it is fair or just for farmers to be provided with additional statutory rights to compensation for restrictions on their property rights in land and water resources. In order to do so, it looks at three issues: how other property rights are treated; the benefits already provided by the state to farmers; and the legal and historical pattern of ownership and control of the relevant resources.

8.2 How are other interests in property treated?

Fairness is a relative term. That is, what is just or fair in a particular instance can only be determined by reference to how similar circumstances are treated. As discussed, there are many different types of property. However, three types of property suffice to demonstrate the range of ways restrictions on property rights have been and are treated: urban land; native title rights; and commercial fishing rights.

⁶⁷ *Smith v ANL Ltd* [2000] HCA 58 at [156], per Callinan J.

⁶⁸ (2000) 204 CLR 493.

⁶⁹ (1997) 190 CLR 513 at 657-661.

⁷⁰ See also *Commonwealth v Western Australia* [1999] HCA 5 at [194], per Kirby J and *Smith v ANL Limited* [2000] HCA 58 at [104], per Kirby J.

Urban planning laws

Since the arrival of Europeans, land owners in urban areas in Australia have had to tolerate an extensive range of restrictions on their property rights. Planning, building, heritage, and, more recently, environmental laws tightly regulate all aspects of the use and development of urban land. These laws are intended to achieve a range of objectives, including protecting human health and safety, ensuring the efficient provision of goods and services, preventing and reducing localised externalities (for example, by preventing incompatible uses from occurring in close proximity to one another), and protecting broader environmental and amenity values. However, urban landowners generally have no right to compensation for the restrictions imposed under these laws.⁷¹ This is despite the fact that urban land is considerably more valuable than rural land, that the laws have significant ramifications for a wide range of commercial enterprises (for example, manufacturing industries and property developers), and that, for many people, their home is their largest asset.

The Productivity Commission (2004) has attempted to distinguish between urban and rural land use restrictions on the grounds that urban planning laws are intended to deal with localised externalities, while presumably rural environmental laws are designed to address broader externalities. In this regard, it has stated:

Urban planning laws and by-laws are designed to internalise what are usually localised externalities, that is, where the effects are largely confined to neighbours. For example, the opportunity cost to one party of not being allowed to build a certain development may be broadly offset by the fact that their amenity will not be diminished by an adjacent development by a neighbour. While such reciprocity is unlikely to be perfect, there is a rough symmetry of costs and benefits, which may explain the acceptance of the rules, and the absence of compensation (Productivity Commission 2004, p.32).

This analysis is incongruous with the nature, purpose and history of urban planning laws. Urban planning laws do address localised externalities. However, they also address a vast array of broader issues.⁷² This fact is reflected in the objects clauses of most state and territory planning laws.⁷³ It is also reflected in the hierarchical structure of most planning systems, where there are two or three layers of planning instruments: local, regional and state. It is plainly wrong of the Productivity Commission to

⁷¹ It is arguable that some planning laws in the territories could bring about an ‘acquisition of property’ for the purpose of s.51(xxxi) of the Constitution, thereby triggering the ‘just terms’ requirement. However, as noted above, caution has been expressed about the operation of general principles to ‘town planning and other special or like powers’ in this context (see, for example, *Commonwealth v Western Australia* [1999] HCA 5 at [280], per Callinan J; and *Commonwealth v Tasmania* [1983] HCA 21 at [73], per Deane J).

⁷² The Productivity Commission may have been seeking to use the phrase ‘urban planning laws’ in a narrow sense to confine it to laws concerning neighbourhood development disputes. Presumably, this would exclude those aspects of urban planning laws that relate to heritage, environmental and broader planning issues such as public health and the efficiency of infrastructure from the definition. Even if this distinction is accepted, the Productivity Commission has still failed to answer the question of why urban landholders should not be compensated for restrictions imposed under the ‘broader’ aspects of urban planning laws.

⁷³ See, for example, *Planning and Environment Act 1987* (Vic), s.4 and *Environmental Planning and Assessment Act 1979* (NSW), s.5.

suggest that restrictions imposed under regional or state planning policies are merely intended to address localised externalities.

The existing arrangements in relation to urban land suggest it would be inequitable to provide rural landowners with additional legal rights to compensation for regulatory restrictions that are imposed for environmental purposes. There also does not appear to be any convincing policy reasons why the property rights of rural landholders should be given preferential treatment over those of urban residents.

Native title rights

Broadly, native title describes the collection of rights and interests possessed by a clan, tribe or individual in land and waters under the 'traditional laws acknowledged and the traditional customs observed' by Indigenous Australians.⁷⁴ These rights and interests survived the acquisition of sovereignty by the Crown and are now recognised under both statute and the common law.⁷⁵ However, they can be, and have been, extinguished by and under laws enacted by Parliament.⁷⁶

The fact that the traditional lands and waters of the vast majority of Indigenous communities have been appropriated is well documented and there is no need to revisit the history of dispossession here. As Brennan J stated succinctly in *Mabo v Queensland [No.2]*:

As the Governments of the Australian Colonies and, latterly, the Governments of the Commonwealth, States and Territories have alienated or appropriated to their own purpose most of the land in this country during the last two hundred years, the Australian Aboriginal peoples have been substantially dispossessed of their traditional lands.⁷⁷

McHugh J expressed similar sentiments in *Western Australia v Ward*:

[Y]ou do not have to be a Marxist to recognise that at least on occasions the dominant class in a society will use its power to disregard the rights of a class or classes with less power. On any view, that is what the dominant classes in Australian society did - and in the eyes of many still do - to the Aboriginal people.⁷⁸

The High Court's decisions in *Mabo v Queensland [No.2]*⁷⁹ and *Wik Peoples v Queensland*⁸⁰, and the enactment of the *Native Title Act 1993* (Cwlth), provided hope that some of the past and present injustices experienced by Indigenous communities would be partially remedied. Most relevantly, they ensured that native title holders

⁷⁴ *Members of the Yorta Yorta Aboriginal Community v Victoria* [2002] HCA 58 at [33], per Gleeson CJ, Gummow and Hayne JJ. For discussion on the nature of native title, see Brennan (2004).

⁷⁵ *Mabo v Queensland [No.2]* (1992) 175 CLR 1. See also *Native Title Act 1993* (Cwlth), s.10.

⁷⁶ The *Native Title Act 1993* now governs the extinguishment of native title, both by the Commonwealth and the states and territories (see *Native Title Act 1993*, s.11 and *Western Australia v Commonwealth* [1995] HCA 47 at [79], per Mason CJ, Brennan, Deane, Toohey, Gaudron and McHugh JJ).

⁷⁷ *Mabo v Queensland [No.2]* (1992) 175 CLR 1 at 68.

⁷⁸ [2002] HCA 28 at [529].

⁷⁹ (1992) 175 CLR 1.

⁸⁰ (1996) 187 CLR 1.

would have formal legal rights to compensation in certain circumstances. While there is considerable complexity associated with these rights, generally native title holders now have a right to compensation if:

- their rights were extinguished during the period 1975 to 1993 in circumstances where compensation would have been payable to non-native title holders; or
- their rights were or are extinguished at some time after July 1993.⁸¹

The limited scope of these rights guarantees that a large proportion of Indigenous Australians will not be entitled to compensation for the loss of native title and the use of, and access to, their traditional lands and waters. Furthermore, these rights to compensation have been rendered virtually worthless by the highly restrictive approach taken by the High Court to determine if native title exists. There are three aspects of the High Court's decisions in *Members of the Yorta Yorta Aboriginal Community v Victoria*⁸², *Western Australia v Ward*⁸³ and *Wilson v Anderson*⁸⁴ that are of particular relevance to this issue.

Firstly, in *Members of the Yorta Yorta Aboriginal Community v Victoria*, the High Court held that native title rights are rights and interests possessed under traditional law, which is the 'body of law and customs acknowledged and observed by the ancestors of the claimants at the time of sovereignty' and it confirmed that 'acknowledgment and observance of those laws and customs must have continued substantially uninterrupted since sovereignty'.⁸⁵ The practical effect of these findings is that the traditions and customs of Indigenous Australians must be frozen in time and have been continually practised to be legally enforceable. As Brennan states:

Freezing social structures and the essential state of traditional law and custom as at 1788 makes proof of native title extremely difficult for Indigenous groups across Australia. More than that, it suggests that the rights which are recognised may not include those arguably best adapted to the contemporary needs of the most disadvantaged sector of the Australian population, that is those laws developed by systems of internal Indigenous governance to cope with post-colonisation realities (Brennan 2003, p. 203).

Secondly, the High Court has held there is no presumption against the extinguishment of native title. At common law, there is a presumption that the legislature does not intend to deprive people of valuable property rights unless it expresses an unequivocal intention to do so. As Lord Atkinson stated in *Central Control Board (Liquor Traffic) v Cannon Brewery Company Limited*:

⁸¹ It is also arguable that native title holders have a right to compensation if their native title rights were extinguished by the Commonwealth or a territory government in circumstances where 'just terms' were not provided. See Brennan (2004) and *Newcrest Mining (WA) Limited v Commonwealth* [1997] HCA 38, per McHugh J, Gummow J and Toohey J.

⁸² (2002) 77 ALJR 356.

⁸³ (2002) 76 ALJR 1098.

⁸⁴ (2002) 76 ALJR 1306.

⁸⁵ *Members of the Yorta Yorta Aboriginal Community v Victoria* (2002) 77 ALJR 356, per Gleeson CJ, Gummow and Hayne JJ.

... (the) intention to take away the property of a subject without giving to him a legal right to compensation for the loss of it is not to be imputed to the Legislature unless that intention is expressed in unequivocal terms.⁸⁶

Following the High Court's decision in *Western Australia v Ward*⁸⁷, it appears this presumption does not apply to native title rights. They are, in effect, treated as second class rights.

Thirdly, the High Court has held that the test to be applied in determining whether native title rights have been extinguished is whether the rights granted in respect of the relevant land or waters are inconsistent with the continued existence and enjoyment of native title rights. No regard is to be had to the use to which land or waters have been put. So, for example, if, under a lease, a person obtained rights that were inconsistent with the continued enjoyment of native title rights, the native title rights would be extinguished irrespective of whether the person exercised rights that were inconsistent with the native title rights.

The combined effect of these last two principles is to make it far more difficult to establish that native title has not been extinguished or, at least partially extinguished, by previous acts (including the creation of rights and interests in land and waters). Obviously, this is extremely important where the act occurred in a period, or under a legislative scheme, when compensation was not payable for the extinguishment of native title.

In summary, while there are formal legal rights to compensation for the abrogation of native title, the scope of these rights and the High Court's recent decisions have combined to ensure that they are of little value to the majority of Indigenous Australians. As Justice McHugh has acknowledged, '(t)he deck is stacked against the native-title holders'.⁸⁸ If the focus of equity were on form rather than substance, the existence of these rights to compensation could be used to support the farmers' claims for additional rights to compensation for restrictions on their property rights. Yet, it is not. Equity has always been focused on substantive outcomes. Therefore, if native title rights are a guide, farmers' claims for compensation for restrictions on property rights should be ignored.

Commercial fishing rights

As is the case with the relationship between irrigators and water, commercial fishers do not own any fish in the ocean or any particular segment of the ocean. Australia's oceans and their living and non-living resources are, in effect, public property.⁸⁹

⁸⁶ (1919) AC 744 at 752. See also *Mabo v Queensland [No.2]* (1992) 175 CLR 1, per Toohey J, and Deane and Gaudron JJ; and *Wik Peoples v Queensland* (1996) 187 CLR 1, per Toohey J, Gaudron J, Gummow J and Kirby J.

⁸⁷ (2002) 76 ALJR 1098.

⁸⁸ *Western Australia v Ward* [2002] HCA 28 at [561].

⁸⁹ At common law, there is a public right to fish in tidal waters. However, this right is 'freely amenable to abrogation or regulation by a competent legislature' (*Harper v Minister for Sea Fisheries* [1989] HCA 47 at [10], per Brennan J). Further, while the Commonwealth does not have a proprietary interest in the oceans within Australia's exclusive economic zone, it undoubtedly has the authority to determine how they are used (see *Commonwealth v WMC Resources Ltd* (1998) 194 CLR 1; *Harper v Minister for Sea Fisheries* (1989) 168 CLR 314; and *New South Wales v The Commonwealth ('the Seas and Submerged Lands Case')* (1975) 135 CLR 337).

Therefore, fishers' property rights in living marine resources are confined to the rights under the fishing licences granted from governments.⁹⁰

Over the past 15 years, steps have been taken to address over-capitalisation and over-fishing in a number of Commonwealth, state and territory-managed fisheries. Fishery and stock specific measures such as licence cancellations, licence buy-backs, reductions in quota allocations, tightening of effort restrictions, and the closure of fishing grounds have occurred in a number of fisheries. In many cases, these changes have been made without compensation being paid to the affected fisheries. However, when regulatory changes cause acute financial harm or there are significant political risks associated with the changes, governments often provide 'restructuring assistance' to affected fishers and associated communities. This can include direct payments as well as assistance with relocating, retraining and finding alternative sources of employment.

Examples of where restructuring assistance has been provided for fishery and stock specific regulatory changes include the recent \$20 million restructuring program for the Queensland East Coast Trawl Fishery, which was jointly funded by the Federal and Queensland Governments (Hill 2001). Similarly, in the 1980s, a joint government-industry restructuring package was established for the Northern Prawn Fishery, which involved the Commonwealth providing a \$3 million grant and guaranteeing a \$40.9 million loan to assist in the acquisition of statutory fishing rights (James 1997; Secretary to the Department of the Treasury and Secretary to the Department of Finance and Administration 1998). The restructuring package saw vessel numbers in the Northern Prawn Fishery reduce from almost 300 to around 130 in the late 1990s (James 1997). Another more recent example was the Victorian rock lobster restructuring package announced in 2001, which was worth \$3.9 million, the majority of which (\$3.1 million) was devoted to a voluntary licence buyback program. In most cases, restructuring payments for the impacts of fishery and stock specific regulatory changes are discretionary, as opposed to being made pursuant to a statutory right to compensation.

In addition to fishery and stock specific regulatory changes addressing over-capitalisation and over-fishing, a number of marine protected areas or marine reserves have been created in several jurisdictions over the past 20 years that have affected fishers' property rights in living marine resources. While marine protected areas may assist in the achievement of fisheries management objectives, they are generally designed to protect biodiversity. That is, they are aimed at public good environment benefits rather than the private benefits associated with fishery and stock specific resource management initiatives.

In many cases, fishers have been provided with compensation where fishing effort has been displaced by the declaration of marine reserves. This occurred in Victoria in 2002, when the state government passed legislation declaring 13 marine national parks and 11 marine sanctuaries.⁹¹ More recently, the Federal Government has pledged to provide compensation to fishers who will be adversely affected by the re-

⁹⁰ Once the fish are caught, the situation changes and, provided they are caught lawfully, they become the property of the relevant fisher.

⁹¹ Victorian Minister for Environment and Conservation, *Parliament Passes Balanced Marine Parks Bill*, Press Release, 13 June 2002.

zoning of the Great Barrier Reef Marine Park which saw the proportion of no-take zones in the Park increase from 4.6 per cent to around 33 per cent.⁹² At the time of writing, the Government had made an allocation of \$10 million for the compensation package, although it has stated this is merely an initial allocation and that further funding may be provided after additional consultation with affected fishers.⁹³

Interestingly, in a small number of cases, fishers have been provided with a statutory right to compensation for the impacts of the declaration of marine reserves. For example, the *National Parks (Marine National Parks and Marine Sanctuaries) Act 2002* (Vic), which established the Victorian marine national parks and marine sanctuaries referred to above, created a statutory right to compensation for affected fishers. Similarly, the *Fishing and Related Industries Compensation (Marine Reserves) Act 1997* (WA) provides people who hold fishing rights in Western Australian fisheries with a statutory right to compensation for the impacts of the establishment or expansion of marine reserves.

Although some governments have provided fishers with a statutory right to compensation as a result of the impacts of the establishment of marine reserves, the Federal Government has recently indicated it has no intention of providing such a right to fishers in Commonwealth-managed fisheries. In a policy statement that was released in early 2004, the Howard Government indicated that where the declaration of marine reserves displaces fishing effort, any compensation that is paid to fishers will be distributed on a discretionary basis (Commonwealth Department of the Environment and Heritage 2004). The policy statement also makes it clear that whether compensation or adjustment assistance will be paid will be determined on a case-by-case basis having regard to the circumstances of the affected fishers and communities (Commonwealth Department of the Environment and Heritage 2004, Part 5).

To summarise, the situation with respect to commercial fishing rights varies considerably. Very rarely is compensation provided to fishers for changes in fishery and stock specific management arrangements and, if it is paid, it is usually made on a discretionary basis. The situation in relation to the displacement of fishing effort that is caused by the establishment or expansion of marine reserves is a little different. Compensation is often paid in these circumstances and there are instances where compensation has been provided pursuant to a statutory right. However, the Commonwealth has recently made it clear that compensation will not always be provided to fishers following the declaration of marine reserves. Therefore, while the treatment of fishers could be used to justify the payment of compensation to farmers on a discretionary basis, there are limited grounds where the plight of fishers is concerned upon which to rely to support the creation of a statutory right to compensation.

⁹² Federal Minister for the Environment and Heritage and Federal Minister for Fisheries, Forestry and Conservation, *RAP funding remains flexible*, Joint Press Release, 12 May 2004.

⁹³ Federal Minister for the Environment and Heritage and Federal Minister for Fisheries, Forestry and Conservation, *RAP funding remains flexible*, Joint Press Release, 12 May 2004.

Treatment of other interests in property

The calls for farmers to be provided with additional legal rights to compensation when their property rights in land and water are restricted in order to achieve environmental objectives (particularly public good environment benefits) seem to be at odds with the way other property rights are treated, particularly urban land and native title rights. In a small number of cases, fishers have been provided with a statutory right to compensation for the impacts of the declaration of marine reserves. However, this appears to be the exception rather than the rule, and the weight of available evidence suggests that where fishers are provided with compensation, it has been, and will be, done on a discretionary basis.

The relatively favourable treatment of commercial fishing rights appears to be consistent with the way other natural resource industries are treated. As discussed above, this can be explained by the ability of these industries to marshal political resources and exert influence over political processes. However, the fact that fishers, farmers and other people involved in natural resource industries are able to mobilise political resources effectively does not support the argument that equity demands they be provided with compensation whenever their property rights are restricted for environmental purposes. Equity requires like treatment of like interests. At present, there are significant differences in the way various kinds of property rights are treated. This suggests there is a need to review the frameworks for the payment of compensation to property owners to ensure there is greater consistency. It does not support the conclusion that farmers should be provided with additional statutory rights to compensation when their property rights in land and water are abrogated for environmental purposes.

Having established that the treatment of other property rights does not support the creation of additional statutory rights to compensation for restrictions on farmers' interests in land and water resources, the following section reviews the available evidence regarding agricultural subsidies and rural benefits.

8.3 Agricultural subsidies and other rural benefits

To assist in determining whether the creation of additional statutory rights to compensation due to restrictions on farmers' property rights in land and water resources is equitable, this section looks at the subsidies and other benefits farmers receive from the state in comparison to other members of the community. The crux of this argument is: why should farmers receive compensation for restrictions on their property rights in land and water if they are already receiving a disproportionate share of public resources? As mentioned above, the payments or subsidies farmers receive from government sources also have important implications for the economic efficiency of providing compensation for restrictions on property rights.

Calculating the relative distribution of public resources to certain industry and social groups is an extremely difficult task and one that is beyond the reach of this paper. However, the available evidence suggests that the agricultural sector is amongst the most highly subsidised industries in Australia.

Table 1 outlines the Productivity Commission's estimates of Commonwealth, state and territory government assistance to four main industry categories (primary, mining,

manufacturing and services) in 2001/02 (Productivity Commission 2002). It is important to note that the primary industry category includes agriculture and several other primary industry groups (for example, forestry and fisheries).

Table 1 Productivity Commission's estimates of industry assistance

	Commonwealth budgetary assistance		State government budgetary outlays (\$m)	Tariff and pricing assistance (\$m)	Total (\$m)	Assistance as a % of IGVA*	Assistance per employee (\$)
	Budgetary outlays (\$m)	Tax concessions (\$m)					
Primary	529.2	133.4	971	211.1	1844.7	8.3	4,212
Mining	75.6	136.4	136	-176.3	171.7	0.5	1,827
Manufacturing	763.7	1099.3	93	4431	6387	8.45	5,817
Services	524.7	368.6	1438	-2298.8	32.5	0.006	4

Source: Productivity Commission 2002.

*IGVA = Industry Gross Value Added.

These statistics suggest that primary industry receives the second largest amount of government assistance (behind the manufacturing sector) and has the second highest rate of assistance relative to output and employment (again, behind the manufacturing sector). However, the statistics only cover government programs that selectively benefit the relevant industry and, by the Productivity Commission's own admission, the coverage is not complete.⁹⁴ Importantly, certain drought relief assistance payments, payments for environmental remediation (for example, the Natural Heritage Trust and the National Action Plan for Salinity and Water Quality), the subsidy effect of quarantine restrictions and the subsidy effect of the under-pricing of water resources are all excluded from the estimates for assistance to primary industry. The exclusion of certain drought assistance payments is particularly relevant.

Around \$1.2 billion in government assistance has been provided to farmers and related producers during the current drought (Drought Review Panel 2004). Between July 2001 and March 2004, the Federal Government alone provided over \$410 million in drought relief payments (Drought Review Panel 2004). This is very similar to what happened during the drought of the early 1990s, which saw the Commonwealth provide \$590 million in drought relief to farmers between September 1992 and December 1995 (Commonwealth Bureau of Meteorology 2004).

The Productivity Commission's estimate of the amount of government assistance given to primary industry also does not include spending on public services and infrastructure that tend to provide disproportionate benefits to farmers due to their location in rural areas. In most cases, the per capita cost of providing public services

⁹⁴ It should also be noted that the level of government assistance provided to industries tends to fluctuate significantly overtime. For example, at the time the Productivity Commission's industry assistance estimates were compiled, it was assumed the level of assistance provided to the sugar industry was gradually being wound back. However, in April 2004, the Howard Government announced a \$444 million Sugar Industry Reform Package, which includes \$21 million in income support payments, \$146 million in 'sustainability grants', and \$39 million in 'grower restructuring grants' (Hon Ian Macdonald, *United Approach to Take Sugar Forward*, Press Release, 29 April 2004 (available at: <http://www.affa.gov.au/ministers/macdonald/releases/2004/04061m.html> (30 May 2004)).

(for example, health, education, garbage collection, policing, and courts) and public infrastructure (for example, roads, telecommunications and sewerage systems) are higher in rural areas than they are in urban areas. This is usually a reflection of lower population densities and/or higher costs associated with geographic isolation. There are also a number of programs that are specifically designed to ensure that there is a degree of equality in the level of public services and infrastructure provided to rural and urban areas. These include the Commonwealth local government grants scheme⁹⁵, Telstra's universal service obligation, Australia Post's universal service obligation, and the Roads to Recovery Program.⁹⁶ Hence, farmers generally benefit from the fact that per capita spending in rural areas on public services and infrastructure is higher than in urban areas.

It seems, therefore, beyond doubt that farmers already receive generous levels of government assistance. Indeed, there is a strong argument that agriculture is the most highly subsidised industry in Australia. Given the high rates of government assistance to farmers, it is difficult to accept that equity demands they receive additional rights to compensation for restrictions on property rights when most other property owners are not entitled to an equivalent right.

8.4 Ownership and control of land and water resources

The final factor that is relevant to determining what is just or fair is the legal and historical pattern of ownership and control of the relevant resource. As previously discussed, the Crown is the ultimate owner of all land. Farmers, like everybody else (other than native title holders), merely hold an estate or interest that is derived from the Crown's title. The fact that the Crown is the ultimate owner of all land suggests it has the right to regulate how the land is used without the need necessarily to compensate landholders for the privilege of doing so.

The counter argument is that the notion of the Crown as the ultimate owner of the land is a hangover from past times that has no relevance in our current society. Most people believe freehold title constitutes ownership of land, potentially absolute ownership. However, as the case of urban landholders demonstrates, ownership of land does not give the owner the right to use the land in any way they please. Further, not all farming land is held under freehold title. Few people would disagree that a lessor has the right to restrict how a lessee uses the subject land or that restrictions can be placed on a licensee's use of property.

⁹⁵ In 2003/04, the Commonwealth provided around \$1.514 billion in financial assistance grant cash payments to local councils. Approximately \$1 billion (or 66 per cent) of these grants were provided to councils in rural and regional Australia (Commonwealth Department of Transport and Regional Services 2004). This is a product of the fact that Commonwealth local government grants are intended to be distributed on a 'full horizontal equalisation basis', which essentially seeks to ensure all councils are able to provide a reasonable standard of services (see *Local Government (Financial Assistance) Act 1995* and Commonwealth Grants Commission (2001)).

⁹⁶ Roads to Recovery is a Commonwealth Government program that is primarily designed to assist local councils in rural and regional areas to maintain and upgrade local roads. Almost \$1 billion was spent on the program between November 2000 and 30 June 2004, of which approximately \$850 million was spent in regional and rural areas. See Hon John Anderson MP, *Budget Shows Road to Recovery*, Press Release, 11 May 2004 (available at: http://www.dotars.gov.au/dept/budget/0405/trs14_budget.aspx (30 May 2004)).

Similarly, farmers do not own the water they extract from rivers and aquifers. The water is effectively owned or controlled by the Crown. What farmers own is a right to extract a certain quantity of water, at a certain time, from a certain river, storage or aquifer, for a certain purpose as has been the case since the turn of the 19th century. Further, farmers have not been required historically to pay the costs associated with water delivery and use. While changes have been made under the COAG Water Reform Framework, farmers still do not pay the full costs associated with their irrigation practices and farm lobby groups maintain that water prices should not be used 'as a policy instrument for delivering environmental outcomes or modifying the behaviour of water users' (National Farmers Federation 2003a, p. 1).

9. Conclusions

The question of whether farmers should be provided with additional statutory rights to compensation should be determined by evaluating whether the creation of these rights is equitable and whether they will lead to a net increase in social welfare. While evaluating the social welfare consequences of the creation of additional rights to compensation is difficult, the equity issues are relatively clear. The nature of farmers' interests in land and water resources, the treatment of other forms of property (particularly native title and interests in urban land), and the extent of government subsidies to agriculture all suggest it would be inequitable to provide these rights to farmers.

With regard to social welfare issues, there is a case for providing farmers with additional statutory rights to compensation for restrictions on property rights in water, but not for land. If additional rights to compensation are created to protect farmers' interests in land it is unlikely to result in a significant increase in agricultural investment or output. However, it will severely restrict the ability of Australian governments to respond to environmental issues and social pressures, divert scarce resources from other government programs, waste resources in costly litigation, diminish incentives to improve land management practices, and provide additional subsidies to agriculture. The net outcome on social welfare is likely to be negative.

The fact that farmers should not receive additional legal rights to compensation for restrictions on their property rights in land does not mean they should never receive compensation. The operation of laws that restrict the commercial use of land will occasionally impose significant financial and social costs on particular farmers and communities. In these circumstances, equity may support the provision of compensation and adjustment assistance to the affected people. However, neither economic nor equity arguments support the creation of additional legal rights to compensation. When there are grounds for compensating farmers and communities for restrictions on property rights in land, compensation payments should be made on a discretionary basis having regard to the nature of the restrictions, the treatment of other property rights, and the circumstances of the affected farmers and communities.

In contrast to the situation with farmers' interests in land, it is arguable that the provision of additional statutory rights to compensation for restrictions on farmers' property rights in water resources could increase net social welfare. Irrigated agriculture is responsible for a large proportion of agricultural output and profits. Therefore, any uncertainty associated with water entitlements has the capacity to result in notable economic consequences. By providing additional legal rights to compensation for changes in water entitlements, governments could lessen uncertainty for irrigators and financiers and thereby encourage greater water trading and additional investment in irrigated agriculture. However, by doing so, governments will limit their ability to respond to environmental and other public benefit issues in the future. It will also divert resources from other government programs, lead to additional subsidies being provided to the agricultural sector and diminish incentives to improve natural resource management practices. As changes in the ecological condition of our water resources and social preferences are inevitable, there is a significant risk that the costs of providing additional rights to compensation could outweigh the benefits to extractive users.

The risk assignment framework proposed under the National Water Initiative has a number of positive aspects. These include the following.

- There is no obligation to provide compensation for reductions in water allocations that arise as a result of attempts to address *known* over-allocation or overuse in water systems. This provision provides the relevant states and territories with a window within which to address stressed and over-allocated surface and groundwater systems before the rights to compensation come into operation. The key here will be whether there is a concerted effort by the states and territories to identify and address over-allocation and overuse in the time provided. The history of the implementation of the COAG Water Reform Framework 1994, particularly in relation to increases in environmental flows, suggests that there are grounds for scepticism about whether this will be achieved.
- The right to compensation proposed under the National Water Initiative is not absolute. Farmers will not be entitled to compensation for reductions in water allocations that are caused by climate change and ‘periodic natural events such as bushfires and drought’.⁹⁷ Further, after 2014, allocations can be reduced by up to three per cent over a ten year period without farmers having a statutory right to compensation if the reductions arise ‘as a result of bona fide improvements in the knowledge of water systems’ capacity to sustain particular extraction levels’.⁹⁸

The main difficulty with the National Water Initiative’s risk assignment framework is that the state is left with a disproportionate amount of the risks associated with reductions in water allocations. When these reductions, specified in water management plans as being necessary to address ‘known over-allocation and/or overuse’ have been effected, the relevant governments will have very little scope to make uncompensated cutbacks in allocations. They will have to compensate farmers if they want to reduce water allocations to address environmental or other public good issues that arise as a result in changes in social preferences. The relevant governments will also be entitled to reduce water allocations by only three per cent over a ten year period in order to address sustainability issues without paying compensation. If reductions of greater than three per cent are required to meet sustainability objectives, the state will be required to buy back entitlements from farmers (either voluntarily or compulsorily).

There are numerous reasons for being sceptical about whether sufficient steps will be taken to address the over-allocation and overuse problems that exist in many catchments prior to the rights to compensation coming into operation. The most obvious of these is the political influence that farmers and farm lobby groups are able to exert on political processes. If appropriate steps are not taken to increase environmental flows in stressed and over-allocated water systems in the period before the rights to compensation commence, the relevant governments will have to overcome substantial financial hurdles in order simply to ensure that extraction levels are sustainable. However, even if the relevant governments take the necessary steps to address over-allocation and overuse issues, the National Water Initiative risk

⁹⁷ Clause 48.

⁹⁸ Clause 49.

allocation framework will still stifle the governments' ability to manage water resources in a manner that maximises social welfare. This is due to the fact that the framework does not provide the governments with sufficient scope within which to make uncompensated reductions in water allocations to address environmental and other public good issues that arise due to ecological variability, climate change and shifts in social preferences.

The apparent inflexibility in the National Water Initiative's risk allocation framework could be viewed as acceptable by some if there were compelling evidence that the creation of the rights to compensation would lead to significant improvements in agricultural investment and output. However, the evidence concerning the impacts of creating more certain property rights in water is unconvincing, with a number of studies suggesting that economic gains could be limited. In addition, under the National Water Initiative risk allocation framework, it is unlikely that farmers will shoulder an appropriate proportion of the costs associated with government programs that are designed to improve environmental flows. As a result, farmers are likely to receive additional subsidies, which will exacerbate problems associated with the overuse of resources and lower social welfare.

In light of these facts, it is likely that the negative social welfare consequences of the risk allocation framework under the National Water Initiative will outweigh any apparent benefits. Clearly, greater scope is required for uncompensated changes to be made in water allocations, irrespective of whether the changes are motivated by a change in government policy or 'bona fide improvements in the knowledge of water systems' capacity to sustain particular extraction levels'. In addition, all governments need to show a greater commitment to full cost recovery water pricing if a more efficient allocation of water resources is going to be achieved.

In summary, the calls from farm lobby groups for a legal right to compensation for restrictions on farmers' property rights in land are excessive and need to be balanced against the needs of the broader community. The rights to compensation that are already provided in the Constitution are adequate and, in some respects, may exceed what is necessary to maximise social welfare. Expanding the rights to compensation to protect farmers' interests in land will result in a large transfer of resources from taxpayers to farmers without any notable improvement in agricultural productivity, environmental outcomes or social welfare. Similarly, the risk allocation framework proposed in the National Water Initiative relating to farmers' property rights in water is inequitable and creates impediments to the efficient allocation of water resources. This aspect of the National Water Initiative should be re-negotiated to ensure the relevant governments have greater scope to make uncompensated reductions in water allocations to achieve environmental and other public good objectives.

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